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# North Carolina's Nonprofit Property Tax Exemption Conundrum

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## NORTH CAROLINA'S NONPROFIT PROPERTY TAX EXEMPTION CONUNDRUM\*

THOMAS A. KELLEY & CHRISTOPHER B. McLAUGHLIN\*\*

*Disputes between nonprofit organizations and local governments over property tax exemptions have been on the increase in North Carolina and beyond. There are two paramount reasons. First, since the Reagan Revolution of the 1980s eliminated block grants and other sources of funding, local governments have struggled to pay their bills and have been compelled to look for new sources of revenue, including stricter application of property tax laws. Second, the nonprofit sector has been transformed by the rise of social entrepreneurship. Responding to the same financial pressures that have squeezed local governments since the 1980s, increasing numbers of nonprofit organizations have adopted fee-generating strategies that, in some cases, make them almost indistinguishable from for-profit enterprises. For local governments, the fact that some nonprofits act like for-profits makes it easier to claim that they do not deserve generous property tax exemptions.*

*The result is a property tax conundrum in North Carolina and beyond. Is it fair that governments' financial books should be balanced on the backs of legitimate charities just because their operations include entrepreneurial elements? On the other hand, how are local governments supposed to fund needed services if they cannot collect taxes on property used for seemingly commercial activities?*

*The authors of this Article approach the property tax conundrum from different angles. Tom supervises a law school-based clinic that sometimes represents entrepreneurial nonprofits that, in his view, are being unfairly and unpredictably hit with property tax bills. Chris, who advises local governments on property tax matters, sympathizes with their need to maximize revenues and*

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*their difficulty in distinguishing between entrepreneurial nonprofits and for-profits. However, they agree on the need for greater consistency in the application of North Carolina's property tax laws. They also agree that entrepreneurial, fee-generating nonprofit organizations should not be forced to pay property taxes in instances where there is a tight nexus between the fee-generating activity and the nonprofit organization's charitable, educational, or religious purpose.*

*This Article illustrates North Carolina's inconsistent treatment of these questions and proposes guidelines that will lead to more consistent and fair application of property tax exemption laws in the future.*

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## INTRODUCTION

Although it may come as a surprise to some readers, the law of charitable property tax exemptions is a hot topic.<sup>1</sup> Disputes between nonprofit organizations and local governments over property tax exemption began percolating around the United States in the 1990s<sup>2</sup> and gained steam during the 2000s, particularly during and after the Great Recession.<sup>3</sup> As later sections of this paper will reveal, North Carolina has not been spared.<sup>4</sup>

Two developments in recent decades have contributed to what is becoming a property tax conundrum. First, local governments have increasingly struggled to pay their bills.<sup>5</sup> Since the Reagan Revolution of the 1980s, funds flowing to local governments have diminished as more nonprofits have been exempted from property taxes,<sup>6</sup> and local actors have been compelled to look for “new sources of revenue” to fund municipal services.<sup>7</sup> For practical and political reasons, nonprofit organizations have been tempting targets.<sup>8</sup> Second, the nonprofit

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1. See Evelyn Brody, *The States' Growing Use of a Quid-Pro-Quo Rationale for the Charity Property Tax Exemption*, 56 EXEMPT ORG. TAX REV. 269, 269 & n.3 (2007) (identifying that charitable property tax exemption disputes are often discussed in the news); see also Joan M. Youngman, *The Politics of the Property-Tax Debate: Political Issues*, in PROPERTY-TAX EXEMPTION FOR CHARITIES 23, 23 (Evelyn Brody ed., 2002) (arguing that charitable property tax exemptions are a “source of continual political controversy”).

2. See Jeffrey D. Russell, Note, *Somewhere Under the Rainbow: The Journey Toward Charitable Property Tax Exemption Solutions*, 28 REV. BANKING & FIN. L. 265, 265 (2009) (recognizing that disputes over charitable property tax exemptions were a “hot issue” in the 1990s).

3. Evelyn Brody, *All Charities Are Property-Tax Exempt, but Some Charities Are More Exempt than Others*, 44 NEW ENG. L. REV. 621, 622–23 (2010); Lowell R. Mintz, Note, *The Rules of the Fight Must Be Fair: States Should Pass a Uniform Code for Nonprofit Hospital Tax Exemption of Real Property*, 26 J.L. & HEALTH 415, 434 (2013) (examining property tax exemptions in the context of nonprofit hospitals).

4. *Infra* Parts II and III.

5. JAMES J. FISHMAN, STEPHEN SCHWARZ & LLOYD HITOSHI MAYER, NONPROFIT ORGANIZATIONS: CASES AND MATERIALS 412 (5th ed. 2015); Daniella Corcuera, Note, *Revisiting the Nonprofit Property-Tax Exemption: An Examination of the Need to Clarify Eligibility*, 32 J.L. & COM. 155, 155–56 (2013) (explaining that “municipalities across the nation are struggling to make ends meet” and are therefore reconsidering property tax exemptions).

6. See FISHMAN ET AL., *supra* note 5, at 412; Mintz, *supra* note 3, at 434 (noting that the Great Recession forced local governments to tax nonprofits).

7. FISHMAN ET AL., *supra* note 5, at 289; Mintz, *supra* note 3, at 434.

8. David A. Brennen, *The Commerciality Doctrine as Applied to the Charitable Tax Exemption for Homes for the Aged: State and Local Perspectives*, 76 FORDHAM L. REV. 833, 842–43 (2007) (arguing that it is politically savvy for local politicians to engage in “invisible revenue-raising objective[s]” by targeting individual nonprofits rather than increasing tax rates across the board); Robert Christopherson & James J. Coffey, *Hedging Property Taxes for Exempt Organizations*, 24 TAX’N EXEMPTS 39, 43 (2012) (highlighting

sector in the United States has become increasingly entrepreneurial<sup>9</sup>—some would say blatantly commercial<sup>10</sup>—and local tax authorities across the country, congressional representatives, as well as members of the general public, have begun to question whether they are deserving of generous property tax exemptions,<sup>11</sup> particularly when those exemptions increase the local tax burden on the rest of the citizenry.<sup>12</sup>

The combined result is a growing property tax exemption conundrum in North Carolina and beyond. On one hand, venerable Anglo-American legal and cultural traditions hold that charitable nonprofit organizations should be exempt from property taxation.<sup>13</sup> On the other hand, local governments and their allies in state legislatures increasingly question whether some of these nonprofit organizations are indeed charitable and whether they should enjoy local governments' and citizens' beneficence, especially in an atmosphere of fiscal contraction.<sup>14</sup>

The authors of this paper approach the charitable property tax conundrum from different angles. Tom supervises a law school-based clinic that provides legal counsel to North Carolina nonprofit organizations. He has represented charitable clients that, in his view, have been unfairly squeezed by local governments seeking to increase

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that charities are tempting targets for taxation partly because there is little downside in attempting to impose taxes upon them other than the cost of litigation).

9. See DAVE ANDERSON ET AL., DUKE UNIV., TERRY SANFORD INST. OF PUB. POL'Y, *THE STATUS OF NONPROFIT PROPERTY TAX EXEMPTION IN THE STATE OF NORTH CAROLINA* 4 (2003), <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.502.6547&rep=rep1&type=pdf> [<https://perma.cc/URY3-SK7Z>] (identifying that “a considerable portion of the nonprofit sector has begun to engage in more commercial activities as a way to generate additional revenue”); see also *infra* notes 39–46 and accompanying text (discussing the rise of entrepreneurial nonprofits).

10. See Thomas Kelley, *Rediscovering Vulgar Charity: A Historical Analysis of America's Tangled Nonprofit Law*, 73 FORDHAM L. REV. 2437, 2438 (2005) (describing nonprofit activities as resembling those of “successful commercial enterprises” due to aims such as “exploit[ing] their comparative advantages” and “recruit[ing] leadership with vision and entrepreneurial zeal”).

11. Stephanie Strom, *Tax Exemptions of Charities Face New Challenges*, N.Y. TIMES, May 26, 2008, at A1 (“Authorities from the local tax assessor to members of Congress are increasingly challenging the tax-exempt status of nonprofit institutions—ranging from small group homes to wealthy universities—questioning whether they deserve special treatment.”).

12. See FISHMAN ET AL., *supra* note 5, at 289–90 (arguing that charitable property tax exemptions erode the local tax base); Woods Bowman, *Impact Fees: An Alternative to PILOTs*, in PROPERTY-TAX EXEMPTION FOR CHARITIES, *supra* note 1, at 301, 302.

13. See Youngman, *supra* note 1, at 25 (claiming there is “a fundamental consensus that charitable organizations should be tax-exempt”).

14. See *id.* at 30–31.

revenues. As a faculty member at the School of Government, Chris provides legal advice to North Carolina local government property tax officials. He sympathizes with their strict interpretation of relevant North Carolina statutes. After all, someone has to pay for fire protection, schools, and police.<sup>15</sup>

Although we approach the problem from different perspectives, we agree that charitable property tax exemption laws, including those in North Carolina, should be clear and consistent and that their application by local taxing authorities should be as fair and evenhanded as possible.<sup>16</sup> We also agree on this Article's main thesis: entrepreneurial, fee-generating nonprofit organizations in North Carolina should not be subject to property taxation when the organizations can demonstrate a close nexus between their nonprofit missions and the fee-generating activity. This paper describes the conundrum that has arisen across the country and that has begun to take shape in North Carolina, and seeks to provide clarity that will help guide nonprofit organizations, local property tax assessors, and state officials.

In pursuit of these goals, we begin in Part I with a brief historical account of how the charitable property tax conundrum arose across the United States and eventually spread to North Carolina. Part II provides a primer on North Carolina charitable property tax exemptions,<sup>17</sup> covering what state laws say about them and how those laws are applied (or misapplied) in practice by local governments. Part III provides case studies that illustrate the charitable property tax conundrum as it has played out in North Carolina in recent years. The case studies reveal a lack of consistency in how property tax assessors deal with fee-generating nonprofit organizations and a general wariness toward entrepreneurial charities. Part III also offers

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15. See ANDERSON ET AL., *supra* note 9, at 2 (arguing local officials in North Carolina view property tax exemptions as “unfunded state mandate[s]”); FISHMAN ET AL., *supra* note 5, at 290 (arguing that many people believe that nonprofits ought “to pay their ‘fair share’ for essential state and local government services”).

16. See ANDERSON ET AL., *supra* note 9, at i (stating that local application of state property tax laws in North Carolina is “erratic”); Catriela Cohen, Note, *Charitable Commerce: Examining Property Tax Exemptions for Community Economic Development Organizations*, 116 COLUM. L. REV. 1503, 1537 (2016) (claiming that inconsistencies in the application of property tax exemption laws hobble charities and suppress innovation in the nonprofit sector).

17. In the case of property tax exemptions, North Carolina law applies the same “exempt use” test to nonprofits engaged in charitable, religious, or educational activities. See *infra* text accompanying notes 80–83. Accordingly, as used in this Article, the term “charitable property tax exemption” will refer to exemptions that cover charitable, religious, and educational nonprofits.

our commentary on how the North Carolina cases should have been resolved and, more generally, where the lines should be drawn when it comes to assessing property taxes on self-supporting charities. We conclude with a summary of the current state of affairs and present suggestions for how to move in the future toward greater consistency and fairness.

### I. THE ROOTS OF THE CHARITABLE PROPERTY TAX CONUNDRUM

For charitable nonprofit organizations that own real estate, property tax bills issued by local governments often come as a rude shock.<sup>18</sup> In many instances, the organizations at issue have already been declared exempt from federal corporate income taxation under Section 501(c)(3) of the United States Internal Revenue Code.<sup>19</sup> Having achieved that status, they assume they will be exempt from state taxation. Indeed, many states automatically grant state corporate income tax exemption to any entity that has achieved Section 501(c)(3) status under federal law.<sup>20</sup> What the nonprofit organizations do not realize is that the state and local legal standards that govern charitable property tax exemptions often diverge significantly from those that govern federal income tax exemptions and that, generally speaking, they are much stricter.<sup>21</sup>

Broadly, the difference between state and federal laws that govern tax exemption boils down to how each body of law defines the terms “charity” and “charitable.”<sup>22</sup> Under federal law, “charity” is defined broadly to encompass practically any activity that provides a benefit to a large and indefinite cross-section of the community, provided the individuals who carry out the activity (for example, board members and managers of charitable nonprofit organizations)

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18. Brody, *supra* note 3, at 625–26; Russell, *supra* note 2, at 267–68.

19. See FISHMAN ET AL., *supra* note 5, at 411 (“Nonprofit organizations that derive their federal income tax exemption under § 501(c)(3) also are likely to enjoy exemption from state and local taxes.”). Section 501(c)(3) is generally considered to be the gold standard of tax-exempt statuses. *Id.* at 291. Among other benefits, qualifying 501(c)(3) organizations are generally exempt from paying federal corporate income taxes. *Id.* at 411. Under a related provision of the Internal Revenue Code, section 170, organizations have the right to receive contributions that are tax-deductible for their donors. I.R.C. § 170(a) (2012).

20. See, e.g., N.C. GEN. STAT. § 105-130.11(a) (2017) (providing that nonprofit organizations exempt from income tax under federal law are automatically exempt under North Carolina law); see also FISHMAN ET AL., *supra* note 5, at 411.

21. FISHMAN ET AL., *supra* note 5, at 62.

22. Brody, *supra* note 1, at 275–76.

do not use the activity and the organization to benefit or enrich themselves.<sup>23</sup>

Significant for purposes of this Article, federal charity law also permits charities to engage in fee-generating, commercial activity.<sup>24</sup> Although federal standards on this point can be maddeningly vague,<sup>25</sup> it is generally understood that a charity may engage in a substantial—and arguably unlimited—amount of commercial activity if that activity is directly in furtherance of the organization’s charitable mission.<sup>26</sup> Federal law even permits a charitable organization to engage in a good deal of commercial activity that is completely unrelated to its mission, so long as the proceeds from that activity are used to cross-subsidize the organization’s charitable purpose.<sup>27</sup>

But all of these federal standards for what constitutes a charity, including the degree to which charities may engage in commercial activity, fly out the window when it comes to state and local charitable property tax exemptions.<sup>28</sup> At those levels, the definition of “charity” is often substantially narrower, sometimes even requiring proof that the organization is relieving burdens on government or aiding the poor and distressed.<sup>29</sup> State and local property tax laws’ definitions of

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23. See Brennen, *supra* note 8, at 833–35 (arguing that the federal legal definition of “charity” has broadened while much of the general public thinks it means aiding the “poor” and “distressed”); see also Kelley, *supra* note 10, at 2472 (discussing federal law’s vague and broad definition of “charity”).

24. Treas. Reg. § 1.501(c)(3)-1(e) (as amended in 1983) (establishing that a nonprofit organization can qualify for tax-exempt status even if it “operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization’s exempt purpose”).

25. Kelley, *supra* note 10, at 2487–89 (describing and criticizing “vague” and contradictory federal charity laws).

26. *Id.* at 2474. To take a simple example, consider a nonprofit organization that provides jobs and job training for blind people by teaching them to manufacture light bulbs. Even if the organization markets and sells the resulting light bulbs at a profit, it will have no problem with the IRS as long as the profits are being directed back into the organization instead of distributed to the individuals who control it. *Id.*

27. *Id.* at 2485–87 (describing the federal “Commensurate in Scope Doctrine,” which permits charities to engage in significant commercial activity unrelated to their charitable missions if the proceeds go to support that mission). Federal law permits nonprofit organizations to engage in commercial activities unrelated to their missions, at least to a certain, somewhat ill-defined, extent. See *id.* at 2484. Organizations are required to pay normal corporate income tax on the profits from such activities. I.R.C. § 511(a)(1) (2012).

28. See FISHMAN ET AL., *supra* note 5, at 62 (noting that state property tax exemption standards are stricter and narrower than their federal counterparts).

29. Brody, *supra* note 1, at 270 (“Recently, lawsuits and legislation (enacted or proposed) asserting tighter definitions for exemption reflect a growing divergence of federal and state policies and a growing acceptance by the states of a quid pro quo rationale for granting exemption.”); Russell, *supra* note 2, at 267–68 (noting that “federal exempt status is hardly sufficient for property tax exemption as a threshold matter”).

charity also tend to be suspicious of, and sometimes outright hostile to, the notion of commercial activity.<sup>30</sup> Thus, in some jurisdictions, charitable organizations—even those that are fully qualified as charitable under Internal Revenue Code Section 501(c)(3)—risk losing their property tax exemptions under locally administered state law if they engage in any commercial activity.

These differences between federal and state and local definitions of charity were largely hidden and mostly ignored through the 1970s.<sup>31</sup> Local governments of that era were less desperate for revenue because they could count on subsidies from federal and state coffers.<sup>32</sup> Charities also had not yet morphed into fee-generating, entrepreneurial enterprises and were, for the most part, still pleasingly charitable.<sup>33</sup>

All of that changed with the advent of the Reagan Revolution. President Reagan was determined to shrink the government and devolve what was left of it down to local control.<sup>34</sup> For counties, cities, and towns, this meant sharp cutbacks in block grants and other sources of funding,<sup>35</sup> combined with more responsibility to provide frontline services that citizens depended upon.<sup>36</sup> At the same time, the nonprofit sector was experiencing similar pressures. The Reagan administration cut federal funds flowing to charities<sup>37</sup> and

30. See ANDERSON ET AL., *supra* note 9, at i (noting that “competition with for profit companies” can cause a nonprofit to forfeit its property tax exemption status); Brody, *supra* note 1, at 277–79 (describing the ways states approach an organization’s profit motive in their definitions of a charitable organization).

31. Christopherson & Coffey, *supra* note 8, at 39 (“Historically, most charitable, educational, and religious organizations were considered sacrosanct in terms of property taxes.”); Corcuera, *supra* note 5, at 155–56 (arguing that, until recently, most property tax exemptions went unchallenged); see also Loren D. Prescott, Jr., *Pennsylvania Charities, Tax Exemption, and the Institutions of Purely Public Charity Act*, 73 TEMP. L. REV. 951, 957 (2000) (highlighting the increasing scrutiny of tax exemptions by local government as a “relatively recent change”).

32. See J. Edward Benton, *The Effects of Changes in Federal Aid on State and Local Government Spending*, 22 PUBLIUS J. FEDERALISM 71, 81 (1992) (“[F]ederal grants in aid had an important influence on the size of state and local government budgets during the 1960s and most of the 1970s.”).

33. See Kelly, *supra* note 10, at 2459–61 (describing a transition period in the 1980s during which charities were forced to commercialize their operations because of budget cuts).

34. See ANDERSON ET AL., *supra* note 9, at 7; Kelley, *supra* note 10, at 2459–61.

35. Richard L. Cole, Delbert A. Taebel & Rodney V. Hissong, *America’s Cities and the 1980s: The Legacy of the Reagan Years*, 12 J. URB. AFF. 345, 347 (1990).

36. Nina J. Crimm, *Why All Is Not Quiet on the Home Front for Charitable Organizations*, 29 N.M. L. REV. 1, 4–8 (1999).

37. *Id.* at 2.

simultaneously extolled their ability to meet Americans' social service needs more efficiently and effectively than government.<sup>38</sup>

The bottom line was that Reagan-era policies required both nonprofit organizations and local governments to do more with less, which put them ineluctably on a collision course. Nonprofit organizations reacted to their financial predicament by becoming more entrepreneurial and self-sustaining.<sup>39</sup> Local governments reacted, at least in part, by trying to collect more revenue from nonprofit organizations, particularly those that were beginning to act more like businesses.<sup>40</sup>

By the 1990s, the nonprofit sector had received the word that it had to get on board with society's celebration of free-market triumphalism and entrepreneurship.<sup>41</sup> The pressure came not just from governments. It became virtually impossible for a nonprofit to compete for private foundation grants<sup>42</sup> without a business plan for sustainability, which usually meant either charging fees for the charitable goods or services it provided or launching an income-generating activity on the side, sometimes completely unrelated to its

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38. Robert T. Grimm, Jr., *Targeting the Charitable Property-Tax Exemption to Collective Goods*, in PROPERTY-TAX EXEMPTION FOR CHARITIES, *supra* note 1, at 321, 322; Kelley, *supra* note 10, at 2460 (arguing that the Reagan administration “cut the federal government with evangelical zeal and rhetorically encouraged the charitable nonprofit sector to take up the slack”).

39. Kelley, *supra* note 10, at 2461.

40. See Christopherson & Coffey, *supra* note 8, at 41 (“As local coffers continue to dry up, a charitable institution consuming local government services without paying property taxes could become a tempting target for a revenue-starved municipality.”).

41. See Kelley, *supra* note 10, at 2467 (“During the 1990s, the trend toward commercialization of charity strengthened as technology-boom millionaires entered the charitable realm and insisted on the adoption of business methods, and as private foundations increasingly adopted the rhetoric and practices of venture philanthropy.”); Youngman, *supra* note 1, at 34–35.

42. Private grant-making foundations are an important source of operating capital for nonprofit organizations in the United States. Cynthia M. Gibson, *Why Every Foundation Should Fund Infrastructure*, NONPROFIT Q. (Jan. 25, 2008), <https://nonprofitquarterly.org/2008/01/25/why-every-foundation-should-fund-infrastructure/> [<https://perma.cc/79F3-BQNX>]. Such foundations range in size and scope from small family foundations that give away a few thousand dollars a year, King McGlaughon, *Think You Know Private Foundations? Think Again.*, STAN. SOC. INNOVATION REV. (Jan. 2, 2014), [https://ssir.org/articles/entry/think\\_you\\_know\\_private\\_foundations\\_think\\_again](https://ssir.org/articles/entry/think_you_know_private_foundations_think_again) [<https://perma.cc/C7XR-9VXH>], to the Bill and Melinda Gates Foundation, which has an endowment of more than \$40 billion and gives away billions of dollars each year, much of it to charitable nonprofit organizations. *Foundation Fact Sheet*, BILL & MELINDA GATES FOUND., <https://www.gatesfoundation.org/Who-We-Are/General-Information/Foundation-Factsheet> [<https://perma.cc/9BF2-SC6U>].

charitable mission.<sup>43</sup> In other words, under pressure from government and philanthropy, nonprofits began to look and act more like for-profit businesses.<sup>44</sup>

The result over the following decades was the emergence of “social entrepreneurship,”<sup>45</sup> which sometimes is referred to as the “Fourth Sector”: organizations that may be classified as charitable under federal section 501(c)(3), but are “hybrid” in that they intentionally blur the boundaries between charity and business.<sup>46</sup> The purpose of such section 501(c)(3) social enterprises is charitable, but they achieve long-term sustainability by heartily embracing entrepreneurial, fee-generating strategies and activities, some of them directly related to their charitable missions, some not.

While this compelled evolution of the nonprofit sector was under way, local governments in North Carolina and beyond were being squeezed dry, forced to look for new sources of revenue to pay for the services their citizens expected.<sup>47</sup> One response could have been to raise property tax rates, but such increases were, and are, politically unpalatable.<sup>48</sup> An easier option was to begin taxing nonprofit organizations,<sup>49</sup> especially those that were acting like businesses.<sup>50</sup> Given growing unease among members of the public about the increasingly commercial nature of certain nonprofit organizations,

43. See Kelley, *supra* note 10, at 2464–66 (describing the rise of “venture philanthropy,” with its emphasis on making charities self-sustaining).

44. *Id.* at 2467; Youngman, *supra* note 1, at 34–35.

45. Kelley, *supra* note 10, at 2463–64.

46. Thomas Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 339–40 (2009).

47. Tracey Gordon, *State and Local Budgets and the Great Recession*, BROOKINGS INST. (Dec. 31, 2012), <https://www.brookings.edu/articles/state-and-local-budgets-and-the-great-recession/> [<https://perma.cc/G339-5TWE>] (describing state and local government budgets as “a prominent casualty of the recent recession”).

48. See Crimm, *supra* note 36, at 3 (maintaining that the public has become more vocal about opposing property tax hikes). In 1978, California voters approved Proposition 13, which amended the state constitution to “roll[] back property tax assessments and cut rates on all property to a maximum of 1 percent of 1975 property values.” William A. Fischel, *Did John Serrano Vote for Proposition 13? A Reply to Stark and Zasloff’s “Tiebout and Tax Revolts: Did Serrano Really Cause Proposition 13?”*, 51 UCLA L. REV. 887, 888 (2004). The initiative helped start a nationwide movement to curb property taxes. Edmund L. Andrews, *The Curse of California’s Proposition 13*, N.Y. TIMES (Jun. 17, 1988), <https://www.nytimes.com/1988/06/17/opinion/the-curse-of-california-s-proposition-13.html> [<https://perma.cc/VQQ8-MVHQ> (dark archive)].

49. See Brennen, *supra* note 8, at 842–43 (arguing that it is politically more popular to engage in “invisible revenue-raising” by bringing more organizations onto the tax rolls than to implement new taxes or higher rates).

50. See Brody, *supra* note 1, at 270 (arguing that public support for charitable property tax exemptions diminishes as nonprofits become more commercial).

local lawmakers could be confident they would not be punished at the ballot box for increasing those organizations' taxes.

Disputes and lawsuits over nonprofit organizations' property tax exemptions initially focused on hospitals and other healthcare organizations.<sup>51</sup> State and local governments argued, with justification, that nonprofit hospitals had grown so commercial that they were indistinguishable from for-profits. They were providing little, if any, charity care, charging outlandish fees, aggressively pursuing patients who failed to pay their bills, paying exorbitant salaries to doctors and administrators, and entering into complex joint venture agreements with for-profit businesses.<sup>52</sup> Lawmakers asked why these organizations, which were for-profit in all but name, and which owned huge swaths of valuable property, should continue to receive property tax exemptions.<sup>53</sup>

The nationwide flurry of hospital cases was merely the tip of the spear. Examples of this pushback against a variety of nonprofit exemptions abound across the nation.<sup>54</sup> For instance, in New Jersey,

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51. See Grimm, *supra* note 38, at 321–24 (describing the debate over nonprofit property tax exemptions and arguing that the move toward commercial charities and the ensuing controversies began in the nonprofit health care industry).

52. Brody, *supra* note 1, at 279 (noting the similarities between for-profit and nonprofit hospitals); Paul Kiel, *From the E.R. to the Courtroom: How Nonprofit Hospitals are Seizing Patients' Wages*, PROPUBLICA (Dec. 19, 2014), <https://www.propublica.org/article/how-nonprofit-hospitals-are-seizing-patients-wages> [https://perma.cc/83T7-4G9B] (describing the debt collection, fee-charging, and charity care practices of nonprofit hospitals).

53. FISHMAN ET AL., *supra* note 5, at 313–14. Often, but not always, the charitable hospitals prevailed and retained their property-tax-exempt status. See generally Janice M. Smith & John V. Woodhull, *Lay of the Land—Where Does Property Tax Exemption for Health Care Entities Stand Now?*, TAX'N EXEMPTS, Jan.–Feb. 2017, at 38, 46 (acknowledging that many nonprofit hospitals “have successfully avoided property taxation for years”). However, state and federal lawmakers were spurred into action, passing laws requiring hospitals to generate regular reports quantifying their charity care and other public benefits if they wished to retain their exempt status. FISHMAN ET AL., *supra* note 5, at 313–17.

54. Chris McLaughlin, *Pushing Back on Non-Profit Property Tax Exemptions*, COATES' CANONS: N.C. LOC. GOV'T L. (Nov. 15, 2016), <https://canons.sog.unc.edu/pushing-back-nonprofit-property-tax-exemptions/> [https://perma.cc/48UP-KBRQ]. A recent NPR article from Connecticut showed that the trend continues, at least in that state:

Assessors in multiple towns and cities are scrutinizing applications from nonprofits requesting tax exemptions. In Norwich, dozens of organizations—previously tax-exempt—have been denied that status for various reasons, including failing to file the proper paperwork. Gian-Carl Casa, president and CEO of the Connecticut Community Nonprofit Alliance, said it's a sign that towns and cities are desperate for revenue. And they think it's a coordinated effort by assessors, in various parts of the state, to just begin assessing taxes on financially hard-pressed nonprofits.

residents of the town of Princeton recently went to court to challenge the property tax exemptions enjoyed by Princeton University, claiming that the university was engaged in a wide variety of commercial activities that went far beyond the role of educating college students.<sup>55</sup> The university settled the case on the eve of trial, agreeing to pay more than \$18 million to be shared by over 800 homeowners, the town, and a nonprofit that provides low-income housing.<sup>56</sup> City officials in Providence, Rhode Island, convinced Brown University to pay around \$6 million per year as “payments in lieu of taxes” in return for the city not challenging the university’s property tax exemptions that cost the city more than \$38 million in lost tax revenue annually.<sup>57</sup> In Maine, the governor has proposed taxing fifty percent of the value of real property owned by all nonprofits other than churches.<sup>58</sup> A Chicago Tribune op-ed contributor proposed similar limits on Illinois’ nonprofit property tax exemptions.<sup>59</sup>

The list of nonprofit organizations whose property tax exemptions were challenged due to their commercial activities is long and varied, including: elder homes for middle class and even wealthy patrons; YMCAs that maintain in-house health clubs; daycare

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Lori Mack, *Dozens of Nonprofits Denied Tax-Exempt Status as Towns and Cities Look for Revenue*, WNPR NEWS (May 1, 2018), <http://wnpr.org/post/dozens-nonprofits-denied-tax-exempt-status-towns-and-cities-look-revenue> [<http://perma.cc/Y4BM-B22X>].

55. The complaint filed by the residents identified a long list of allegedly for-profit businesses operated by Princeton University, including copyright and trademarking businesses and enterprises involving venture capital investing, commercial and residential real estate, commercial television, and private mortgage banking. Complaint at 7, *Fields v. Trs. of Princeton Univ.*, Nos. 005904-2014, 007556-2015, and 007672-2016 (N.J. Tax Ct. Apr. 1, 2015). A separate decision in the case concerning the burden of proof borne by the university to defend its property tax exemptions is reported at *Fields v. Trs. of Princeton Univ.*, No. 010656-2011 (N.J. Tax Ct. Nov. 5, 2015). A separate decision concerning court fees is reported at *Fields v. Trs. of Princeton Univ.*, No. 007672-2016 (N.J. Tax. Ct. May 31, 2016).

56. Elise Young, *Princeton Will Pay \$18 Million to Settle Residents’ Tax Case*, BLOOMBERG (Oct. 14, 2016), <https://www.bloomberg.com/news/articles/2016-10-15/princeton-will-pay-18-million-to-settle-residents-tax-case> [<https://perma.cc/QJ73-Q87Z> (dark archive)].

57. See I. Harry David, *Brown University, PILOTS, and Tax Exemption*, TAX FOUND. (May 10, 2012), <https://taxfoundation.org/brown-university-pilots-and-tax-exemptions> [<https://perma.cc/4KCV-S8SG>].

58. Elaine S. Povich, *Should Nonprofits Have to Pay Taxes?*, PEW CHARITABLE TRS. (Mar. 5, 2015), <http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2015/3/05/should-nonprofits-have-to-pay-taxes> [<https://perma.cc/9QRF-V29K>].

59. David M. Simon, *Commentary: Abolish Property Tax Exemptions for Rich Nonprofits*, CHI. TRIB. (June 27, 2017), <http://www.chicagotribune.com/news/opinion/commentary/ct-perspec-propertytax-0628-jm-20170627-story.html> [<https://perma.cc/N629-XRKJ>].

centers; community economic development organizations and business incubators in low-income neighborhoods;<sup>60</sup> and, in a few instances, even churches<sup>61</sup> that have strayed too far into the commercial realm. What these organizations had in common is that they were federally tax-exempt nonprofits under Internal Revenue Code Section 501(c)(3) and they engaged in some sort of commercial, fee-generating activity as part of their operations. Against this historical backdrop of evolutionary changes to local government financing and the nonprofit sector, we narrow the focus, and attempt to bring some clarity, to property tax exemptions as applied to entrepreneurial nonprofits in North Carolina.

## II. PROPERTY TAX EXEMPTIONS IN NORTH CAROLINA

Although property taxes in North Carolina are levied by local governments, property tax exemptions are creatures of state law. Exemptions and their near-identical siblings, exclusions,<sup>62</sup> can be

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60. See generally Brody, *supra* note 1, at 277–83 (discussing various sorts of nonprofit organizations that have been subject to property-tax exemption challenges).

61. Youngman, *supra* note 1, at 31–32.

62. The terms “exemption” and “exclusion” both refer to property that is removed from the tax base and, therefore, not subject to local property taxes. There is not much of a practical difference between the two terms, other than the fact that exemptions completely remove the covered property from the tax base while some exclusions remove only a portion of the covered property’s value from the tax base. The technical difference between the two terms relates to the state constitutional authority for the General Assembly to enact exemptions and exclusions.

Property tax *exemptions* arise under article V, section 2(3) of the North Carolina Constitution, which requires that property belonging to state and local governments be completely exempt from local property taxes. N.C. CONST. art. V, § 2(3) This government property tax exemption, the only one that is constitutionally required, takes statutory form in section 105-278.1. N.C. GEN. STAT. § 105-278.1 (2017). Article V, section 2(3) also permits the General Assembly to exempt cemeteries and “property held for educational, scientific, literary, cultural, charitable, or religious purposes . . .” N.C. CONST. art. V, § 2(3). The General Assembly exercised the option to completely exempt from local property taxes these types of property uses by adopting the following statutory provisions: N.C. GEN. STAT. § 105-278.2 (2017) (cemeteries); *id.* § 105-278.3 (religious property); *id.* § 105-278.4 (educational property); *id.* § 105-278.5 (religious educational property); *id.* § 105-278.6 (charitable property); *id.* § 105-278.7 (educational, scientific, literary, and charitable property); and *id.* § 105-278.8 (charitable hospital property). As the parenthetical descriptions suggest, there is substantial overlap among these exemptions.

In contrast, the authority for the General Assembly to *exclude* (partially or completely) property from local property taxes is found in article V, section 2(2) of the North Carolina Constitution. N.C. CONST. art. V, § 2(2). The General Assembly has used this authority to exclude from property taxes at least part of the value of hundreds of different types of property ranging from disabled veterans’ homes, N.C. GEN. STAT. § 105-277.1C (2017), to antique airplanes, *id.* § 105-277.12, to property owned by the Loyal Order of Moose, *id.* § 105-275(19).

created only by the North Carolina General Assembly and must be uniformly applicable across the state.<sup>63</sup> This uniformity requirement, enshrined both in state statute and the state constitution, forbids the General Assembly from creating property tax exemptions using “local exemption/exclusion bills” that apply only to certain areas of the state.<sup>64</sup> It also prohibits local governments from creating their own exemptions or from opting out of exemptions created by state law.<sup>65</sup> As a result, property owners in coastal Dare County are subject to the same property tax exemption rules that apply 500 miles away in mountainous Cherokee County. The uniformity requirement ensures that all property in North Carolina, both real and personal, is taxable unless a specific exemption applies.<sup>66</sup> The burden of proving eligibility for an exemption falls on the taxpayer.<sup>67</sup> If the taxpayer fails to provide the evidence necessary to prove eligibility for an exemption, the property in question will be taxed.<sup>68</sup>

As is true across much of the nation, eligibility for most North Carolina property tax exemptions depends on both ownership and use. Property owned by a nonprofit engaged in religious, educational, or charitable activities must be “wholly and exclusively” used for one of those exempt purposes to qualify for an exemption.<sup>69</sup> In other words, it is not sufficient for the property to be owned by a qualifying taxpayer.<sup>70</sup> The qualifying owner must use the property for an exempt purpose. That means that a church, a synagogue, a mosque, a private school, or a charitable nonprofit organization, such as Meals on Wheels or Habitat for Humanity, seeking a property tax exemption

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To avoid unnecessary complexity and qualification, this Article will use the term “exemption” to include both exemptions and exclusions under North Carolina law.

63. N.C. CONST. art. V, § 2(2).

64. Chris McLaughlin, *The N.C. Constitution’s Uniformity Clause*, COATES’ CANONS: N.C. LOC. GOV’T L. (June 9, 2011), <https://canons.sog.unc.edu/the-n-c-constitutions-uniformity-clause/> [<https://perma.cc/RLC5-KYBF>] (“[O]nly the General Assembly, not local governments, can classify property for exemptions and exclusions. And when making those classifications, the General Assembly may do so only through laws of statewide application, meaning no local exemption/exclusion bills that affect only certain counties.”).

65. *See id.*

66. N.C. CONST. art. V, § 2(2).

67. *In re Appeal of Eagle’s Nest Found.*, 194 N.C. App. 770, 773, 671 S.E.2d 366, 368 (2009).

68. *Id.* (“Statutory provisions providing for exemptions from taxes are to be strictly construed, and all ambiguities are to be resolved in favor of taxation.” (quoting *In re Appeal of Totsland Preschool, Inc.*, 180 N.C. App. 160, 164, 636 S.E.2d 292, 295 (2006))).

69. N.C. GEN. STAT. §§ 105-278.3(a), -278.4(a)(4), -278.7(a)(1) (2017).

70. In some cases, ownership by a qualified taxpayer is not required so long as the use requirement is satisfied. For example, real property used by a public charter school for educational purposes is exempt, even if that property is owned by another party and leased to the charter school. *Id.* § 105-275(46).

must use its property for an exempt purpose, such as religious worship, classroom instruction, or the provision of meals or housing to low-income individuals.

This use requirement is best illustrated by the facts and decision in *Rockingham County v. Board of Trustees of Elon College*,<sup>71</sup> a foundational case in North Carolina property tax law. It involved an attempt by a private college to exempt from taxation an office building it owned and rented to private businesses.<sup>72</sup> The college admitted that it was not using the office building for educational purposes but argued that the property should still be exempt because the college was using the revenue from the office building to fund its educational activities.<sup>73</sup> The court disagreed, observing that for property to be exempt from taxes it must be

withdrawn from the competitive field of commercial activity . . . . [W]hen it is thrust into the business life of the community, it loses its sheltered place, regardless of the character of the owner, for it is then held for profit or gain. . . . It is not the character of the corporation or association owning the property which determines its status as respects the privilege of exemption, but the purpose for which it is held. . . . It is the use of property other than in private competitive business that justifies its exemption from taxation.<sup>74</sup>

Although the opinion was issued in 1941, long before the exemption statutes included an explicit use requirement, the court concluded that the state constitution implied a use requirement for property that was exempted on charitable, religious, or educational grounds.<sup>75</sup>

The *Elon College* opinion originally mandated a use test for property owned by governments as well as property owned by charitable, educational, and religious nonprofits. However, the Supreme Court of North Carolina struck down the use requirement for *government* property tax exemptions forty years later in *In re University of North Carolina*.<sup>76</sup> Today, all property owned by state

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71. 219 N.C. 342, 13 S.E.2d 618 (1941).

72. *Id.* at 344, 13 S.E.2d at 620.

73. *Id.*

74. *Id.* at 345–46, 13 S.E.2d at 621 (citations omitted).

75. *Id.*

76. 300 N.C. 563, 268 S.E.2d 472 (1980). Dating back to 1868, the North Carolina State Constitution has exempted state and local government property without requiring that the property be used for a particular purpose. N.C. CONST. art. V, § 2(3) (“Property belonging to the State, counties, and municipal corporations shall be exempt from taxation.”). However, when that constitutional exemption was first codified in statutory

and local governments,<sup>77</sup> and essentially all property owned by the federal government,<sup>78</sup> is exempt from North Carolina property taxes regardless of use.<sup>79</sup>

form in 1885, the legislature added a requirement that government property be used for public purposes in order to be exempt. Act of Mar. 11, 1885, ch. 177, § 16(1), 1885 N.C. Pub. L. 296, 302. This statutory use requirement for government property remained in place for nearly one hundred years, until section 105-278.1 was codified in 1973. Act of May 23, 1973, ch. 695, § 4, 1973 N.C. Sess. Laws 1024, 1027 (codified as amended at N.C. GEN. STAT. § 105-278.1 (2017)). The use requirement was successfully challenged in 1980 by the University of North Carolina in response to an effort by the Orange County tax assessor to tax the Carolina Inn, an on-campus upscale hotel owned by the University. *In re Univ. of N.C.*, 300 N.C. at 563, 268 S.E.2d at 473–74. Both parties agreed that the hotel was government property because it was owned by an agency of the state and was being used, at least in part, for commercial purposes as a hotel open to the public. The University argued that, under the long-standing constitutional exemption, the use of government property was irrelevant to its exempt status. The court agreed and struck down the statutory public use requirement for the government property exemption: “State owned property is exempt from ad valorem taxation solely by reason of State ownership, regardless of the property’s use.” *Id.* at 577, 268 S.E.2d at 481. Although this decision rendered the use requirement unenforceable for government property, that language remained part of the statute for nearly a decade. *See* Act of Aug. 12, 1987, ch. 777, sec. 1, § 105-278.1(b), 1987 N.C. Sess. Laws 1597, 1597 (codified as amended at N.C. GEN. STAT. § 105-278.1(b) (2017)). Chapter 777, section 1 of the 1987 Session Laws of North Carolina finally removed the public purpose requirement from the government property exemption statute. *Id.*

77. N.C. GEN. STAT. § 105-278.1(b) (2017).

78. *Id.* § 105-278.1(a). Federal property is exempt from state and local taxation unless Congress specifically authorizes such taxation. *See id.* § 105-278.1(a)–(b); *Clallam Cty. v. United States*, 263 U.S. 341, 342–43 (1923); *McCulloch v. Maryland*, 17 U.S. 316, 435–37 (1819); *see also* 12 U.S.C. § 548 (2012) (statute waiving federal immunity to allow states to tax the real property of national banks).

79. State courts still occasionally wrangle over what constitutes ownership of government property. *See In re Appeal of Fayette Place LLC*, 193 N.C. App. 744, 747–48, 668 S.E. 354, 357 (2008) (involving a public housing project owned by a limited liability corporation (“LLC”) that was, in turn, a wholly-owned subsidiary of a public housing authority). The court in *Fayette Place* concluded that the housing-project property was exempt government property because a government agency (the housing authority) owned the LLC that owned the property. *Id.* Courts in North Carolina also sometimes face disputes about whether public funds may be expended on what appears to be commercial activity on government property. *See Peacock v. Shinn*, 139 N.C. App. 487, 490, 492, 533 S.E.2d 842, 845–46 (2000) (regarding a dispute over use of revenue from basketball arena owned by the City of Charlotte); *Madison Cablevision, Inc. v. City of Morganton*, 325 N.C. 634, 636, 386 S.E.2d 200, 201 (1989) (regarding an unsuccessful challenge to statute authorizing publicly owned cable television systems). But the basic concept that government property is exempt regardless of use is no longer up for debate. Note that, while commercial use of government property does not render that property itself taxable, it may create a tax obligation for private parties making use of that property. General Statutes section 105-275(31) makes leasehold interests in exempt government property taxable to the private lessee. N.C. GEN. STAT. § 105-275(31) (2017). For example, the Carolina Panthers pay one dollar per year to the City of Charlotte to lease the city-owned land on which their privately-owned stadium sits. Jim Morrill, *Carolina Panthers, Charlotte Knights Just Scored a Big Break on Their Property Taxes*, CHARLOTTE

That said, the use requirement described in the *Elon College* case remains firmly entrenched for religious,<sup>80</sup> educational,<sup>81</sup> and charitable<sup>82</sup> property tax exemptions for private property. The “wholly and exclusively used” language in those exemption statutes<sup>83</sup> has been the subject of much debate among tax officials, property owners, and the courts. As the case studies discussed in the next section demonstrate, those debates continue to rage, in large part, because the exemption statutes do not provide much guidance to explain exactly what constitutes a religious, educational, or charitable purpose and whether a nonprofit can engage in commercial activities as part of its exempt purpose. North Carolina’s current property tax exemption conundrum arises partly out of this lack of clarity.

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OBSERVER (June 27, 2018, 4:13 PM), <https://www.charlotteobserver.com/news/politics-government/article213838884.html> [<https://perma.cc/5D2D-8VRY>]. That land is exempt from property taxes as government property. *Id.* But in 2017, the Panthers paid more than \$350,000 in property taxes on their below-market lease with the city, in addition to the \$1.8 million they paid in property taxes on their privately-owned stadium. *See* Mecklenburg Cty. Tax Bill No. 0001548831-2016-2016-0000-00, Panthers Stadium LLC - LHI, <https://taxbill.co.mecklenburg.nc.us/publicwebaccess/BillSearchResults.aspx?ClickItem=NewSearch> [<https://perma.cc/2NUF-3825> (staff-uploaded archive)] (search by bill number 0001548831 for the year 2016); Mecklenburg Cty. Tax Bill No. 0001695910-2016-2016-0000-00, <https://taxbill.co.mecklenburg.nc.us/publicwebaccess/BillSearchResults.aspx?ClickItem=NewSearch> [<https://perma.cc/5BCC-5RHD> (staff-uploaded archive)] (search by bill number. 0001695910 for the year 2016). Of course, should government real property be leased to a religious, educational, or charitable organization, and should that leased property be used for an exempt purpose, then the leasehold interest would be exempt just as if the real property were owned by the qualifying property owner and used for an exempt purpose. For more details on the taxation of leasehold interests in exempt government property, see Chris McLaughlin, *Government Property, Private Leases, and Property Taxes*, COATES’ CANONS: N.C. LOC. GOV’T L. (Dec. 16, 2011), <https://canons.sog.unc.edu/government-property-private-leases-and-property-taxes/> [<https://perma.cc/K633-4E67>]. Note that North Carolina Senate Bill 2017-114 would eliminate the taxation of leasehold interests in exempt government property by including them in the general exclusion for intangible property. S.B. 114, 2017 Gen. Assemb., Reg. Sess., (N.C. 2017). That bill had not become law as of the date of this publication.

80. *See generally In re* Vienna Baptist Church, 241 N.C. App. 268, 773 S.E.2d 97 (2015) (holding that the church’s property did not qualify for religious purposes property tax exemption).

81. *See generally In re* Appeal of Atl. Coast Conference, 112 N.C. App. 1, 434 S.E.2d 865 (1993) (concluding that the Atlantic Coast Conference administrative office building qualified for the educational institution tax exemption because it was used for activities incident to the operation of an educational institution), *aff’d*, 336 N.C. 69, 441 S.E.2d 550 (1994) (per curium).

82. *See generally In re* Appeal of Totsland Preschool, Inc., 180 N.C. App. 160, 636 S.E.2d 292 (2006) (holding that a nonprofit corporation that provided child care services to the community qualified as a charitable entity and was entitled to exemption from ad valorem taxes).

83. N.C. GEN. STAT. §§ 105-278.3(a), -278.4(a)(4), -278.7(a)(1) (2017).

Before analyzing the exemption statutes and the case law arising under those statutes, a quick note about property tax procedure might be helpful. All of the cases discussed in this Article are property tax appeals. In North Carolina, county assessors are responsible for making the initial decisions regarding property ownership, situs (location), value, and exempt status for property tax purposes.<sup>84</sup> A taxpayer may informally protest those decisions to the assessor and her staff. If that informal appeal does not resolve the issue, the first step in a formal property tax appeal is to the county board of equalization and review (“BOER”).<sup>85</sup> If the BOER rules in favor of the taxpayer, then the matter is closed—the BOER speaks for the county, and the county is not permitted to appeal its own decision. If the BOER rules in favor of the county, the taxpayer is permitted to appeal the matter to the State Property Tax Commission (“PTC”).<sup>86</sup> Whichever party loses at the PTC may appeal the issue to the state court of appeals and, possibly, to the state supreme court.<sup>87</sup>

#### A. *The Religious Exemption*

Section 105-278.3 of the General Statutes of North Carolina explicitly includes in its definition of “religious purpose” the use of property for administrative offices and clergy housing.<sup>88</sup> But the statute is silent about the many other types of activities in which religious congregations commonly engage beyond worship services that include commercial components.<sup>89</sup> For example, are daycare centers operated by a religious congregation exempt “religious purposes”?<sup>90</sup> How about bookstores or cafés? Does it matter whether

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84. *See id.* § 105-296(a) (2017).

85. *Id.* § 105-322(g)(2).

86. *Id.* § 105-290.

87. *Id.* §§ 105-345, -345.4.

88. *See id.* § 105-278.3(d)(1).

89. *Id.*

90. Although North Carolina courts have not been faced with this specific question, the North Carolina Court of Appeals did indirectly address the issue of religious daycare centers when resolving a dispute over the taxable status of a privately owned, secular daycare center. *See In re Appeal of Chapel Hill Day Care Ctr., Inc.*, 144 N.C. App. 649, 659, 551 S.E.2d 172, 178 (2001). In that case, the property owner argued that it was unconstitutional for North Carolina law to exempt daycare centers run by churches, but tax similarly situated daycare centers not affiliated with churches. *Id.* The court rejected that argument, calling the distinction an “acceptable accommodation of religion.” *Id.* at 660, 551 S.E.2d at 179 (quoting *In re Appeal of Springmoor, Inc.*, 348 N.C. 1, 7, 498 S.E.2d 177, 181 (1998)). The court quoted testimony from the Orange County tax assessor to the effect that he routinely exempted church daycare centers that were part of the “mission” of their churches. *Id.* at 659, 551 S.E.2d at 178. The opinion does not address what evidence would be needed for a taxpayer to prove that its daycare center was part of its

they are located in or next to the buildings used for worship services? Are organizations that are open to the general public and charge market rates for their services and goods exempt?

The most on-point North Carolina court opinion to date concerning a religious organization's commercial activity involved a summer camp run by the United Methodist Church.<sup>91</sup> In that case, the Randolph County tax office argued that, because the camp was often made available to the general public and a small fee was charged for some campers, the property could not satisfy the religious use requirement and, therefore, did not qualify for a property tax exemption.<sup>92</sup> The North Carolina Court of Appeals disagreed, finding substantial evidence that most of the camp was used for religious activities, including “[w]orship, meditation, and Bible studies.”<sup>93</sup> In the eyes of the court, this religious activity, combined with the fact that the church clearly did not attempt to make a profit from the camp, led to the conclusion that “the primary purpose of the camp was to serve the religious and spiritual needs of the members of the Methodist Church.”<sup>94</sup> That conclusion did not cover the entire parcel of land owned by the church, however, as the court applied the principles espoused in the *Elon College* case and upheld the taxation of a portion of the camp property that was used for commercial timber production.<sup>95</sup> The court rejected the county's suggestion that this timber production should disqualify the rest of the camp property from exemption, observing that “the sale of the timber on a portion of the larger tract is not a basis for converting the entire tract into a commercial venture.”<sup>96</sup>

### B. *The Educational Exemption*

Section 105-278.4 states that the term “educational purpose” covers student housing, dining halls, and athletic facilities, which are uses that do not involve traditional classroom instruction but that are

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religious mission or whether a daycare center that charges market rates for its services could be considered a religious use.

91. *See generally In re Appeal of Mount Shepherd Methodist Camp*, 120 N.C. App. 388, 462 S.E.2d 229 (1995) (discussing whether property owned by the United Methodist Church qualified for property tax exemption).

92. *Id.* at 391, 462 S.E.2d at 231. Some campers were charged \$5.00 per night or \$1.50 per day. *Id.* at 389, 462 S.E.2d at 230.

93. *Id.* at 391–92, 462 S.E.2d at 231–32.

94. *Id.* at 391, 462 S.E.2d at 231.

95. *Id.* Twenty-four acres of the 532-acre parcel were used for commercial timber production. *Id.* at 389–90, 462 S.E.2d at 230–31. The PTC previously held that those twenty-four acres were not eligible for a religious property tax exemption. *Id.*

96. *Id.* at 391, 462 S.E.2d at 231.

generally viewed as reasonably related to the core mission of a private school or college.<sup>97</sup> The statute does not, however, create clear rules for when non-classroom activity becomes commercial and, therefore, taxable.

Consider a university-owned building that contains space leased to a chain restaurant that serves the public as well as university students and staff. Would that still qualify as an exempt dining hall? Neither the statute nor the courts have provided clear guidance about how much commercial activity is too much to support an educational exemption. One of the few cases addressing this issue involved the sports empire overseen by the Atlantic Coast Conference (“ACC”).<sup>98</sup>

In this case, Guilford County attempted to tax \$974,518 in property owned by the ACC, an unincorporated association comprised of the universities that are members of that athletic conference.<sup>99</sup> The ACC applied for an exemption pursuant to chapter 105, section 278.4 of the General Statutes of North Carolina but was turned down initially by the county’s tax department and then by its BOER. The ACC appealed to the North Carolina PTC, which reversed the BOER and found that the ACC qualified for the exemption. Guilford County appealed to the state court of appeals. The court first ruled that all property listed by the ACC could qualify for an educational exemption because property owned by an unincorporated association belongs to its members.<sup>100</sup> Then the court addressed the main argument raised by the county: was the ACC property used for educational purposes?<sup>101</sup> Perhaps not surprisingly, given the popularity of college basketball in North Carolina<sup>102</sup> and the

97. See N.C. GEN. STAT. § 105-278.4(f)(2) (2017).

98. See generally *In re Appeal of Atl. Coast Conference*, 112 N.C. App. 1, 434 S.E.2d 865 (1993) (examining whether the ACC qualified for an educational purpose property tax exemption), *aff’d*, 336 N.C. 69, 441 S.E.2d 550 (1994) (per curiam).

99. *Id.* at 3, 434 S.E.2d at 866. In 1989, the relevant date for purposes of the property tax appeal in question, the ACC had eight member schools: Clemson, Duke, Georgia Tech, Maryland, North Carolina, North Carolina State, Virginia, and Wake Forest. At the time of the appeal, that number had risen to nine (Florida State joined the conference in 1991). *Id.* Today, the ACC has fifteen member schools (Maryland has left the conference and Boston College, Louisville, Miami, Notre Dame, Pittsburgh, Syracuse, and Virginia Tech have joined). See *Atlantic Coast Conference Teams*, ESPN, [http://www.espn.com/mens-college-basketball/conferences/teams/\\_id/2/acc-conference](http://www.espn.com/mens-college-basketball/conferences/teams/_id/2/acc-conference) [<https://perma.cc/CBA5-6GDU>].

100. *Atl. Coast Conference*, 112 N.C. App. at 5, 434 S.E.2d at 868.

101. See *id.* at 8–11, 434 S.E.2d at 869–71 (addressing the ACC property’s use in performance of educational activities qualifying for an educational tax exemption).

102. North Carolina was recently named the best state for college basketball. See Joe Boozell, *College Basketball: Which States Are the Strongest?*, NCAA (Feb. 25, 2016), <http://www.ncaa.com/news/basketball-men/article/2016-02-24/college-basketball-which->

state's role as the birthplace of the conference,<sup>103</sup> the court concluded that yes, the ACC's activities were in fact educational and deserving of the educational exemption.<sup>104</sup> Citing a Kansas case involving the National Collegiate Athletic Association, the court concluded that negotiating television contracts for conference sporting events, organizing conference athletic tournaments, and promoting college sports in general were all "necessarily incidental to the operation of educational institutions" and, therefore, qualified as educational uses.<sup>105</sup> The fact that the ACC's activities were overtly commercial in nature—the conference earned between \$24 and \$28 million in 1989 and around \$373 million in 2016<sup>106</sup>—was insufficient to disqualify the ACC from an educational exemption, but the court did remand the case back to the PTC to determine if any ACC employees earned unreasonable compensation.<sup>107</sup> The PTC determined that there was no unreasonable compensation,<sup>108</sup> and the ACC's educational exemption continues to this day.<sup>109</sup>

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states-are-strongest [<https://perma.cc/V2BJ-E7WX>]. The Duke-UNC college basketball rivalry is routinely named as one of the top rivalries in all of sports. See *The End of the Century: The 10 Greatest Rivalries*, ESPN (Jan. 3, 2000), <http://www.espn.com/endofcentury/s/other/bestivalries.html> [<https://perma.cc/9GZD-DNFY>].

103. See Barry Jacobs, *ACC Anniversary Marks a Milestone for Power Conferences*, NEWS & OBSERVER (Raleigh May 8, 2017, 6:31 PM), <http://www.newsobserver.com/sports/college/acc/article148908824.html> [<https://perma.cc/EU6A-R36F>]. The ACC was formed in Greensboro, North Carolina, in 1953. *Id.*

104. *Atl. Coast Conference*, 112 N.C. App. at 11, 434 S.E.2d at 871.

105. *Id.* at 9, 434 S.E.2d at 870.

106. *Id.* at 8, 434 S.E.2d at 869. The figures referenced in the text do not include revenue earned by individual member schools from athletics. Florida State alone earned over \$113 million from athletics in 2016, while the University of North Carolina earned just over \$95 million. See *List of NCAA Finances for 2015–16*, USA TODAY, <http://sports.usatoday.com/ncaa/finances/> [<https://perma.cc/YSL7-6MPH>]; see also Steve Berkowitz, *ACC Revenues Drop by \$30 Million in 2016 After Jump Due to Maryland Exit Fee*, USA TODAY (May 19, 2017), <https://www.usatoday.com/story/sports/college/2017/05/19/acc-revenues-drop-30-million/101881486/> [<https://perma.cc/U8YU-8SAY>].

107. *Atl. Coast Conference*, 112 N.C. App. at 7–8, 434 S.E.2d at 869. The ACC's commissioner earned roughly \$180,000 in 1989, which the court found to be reasonable. *Id.* at 7, 434 S.E.2d at 868. It is fair to question whether a court would reach that same conclusion today. Adjusted for inflation, in 1989 the commissioner's salary of \$180,000 would have been over \$352,000 in 2016. *CPI Inflation Calculator*, U.S. DEP'T LAB., [https://www.bls.gov/data/inflation\\_calculator.htm](https://www.bls.gov/data/inflation_calculator.htm) [<https://perma.cc/GXJ5-FNUC>] (stating that \$180,000 in January 1989 has the same buying power as \$352,146 in January 2016). John Swofford, the current ACC commissioner, earned just under \$3 million in 2016. See Berkowitz, *supra* note 106.

108. E-mail from Stephen W. Pelfrey, Gen. Counsel, N.C. Dep't of Revenue, to author (Nov. 2, 2017) (on file with the North Carolina Law Review) (explaining that there was no official PTC determination on compensation. Guilford County agreed to exempt the ACC's property, and the PTC file was closed without a subsequent hearing). Note that the remand focused only on ACC employee salaries, not the salaries of those employed by the

The result in the ACC property tax dispute suggests that North Carolina courts will be lenient and flexible when determining what commercial activities are reasonably related to educational purposes. But that is not always true, as our case study of the University of Human Goodness reveals.<sup>110</sup> In that case, a student-run café was deemed taxable because it was not tied closely enough to the university's educational purpose despite the university's emphasis on student collaboration and group work. Clearly, not all educational organizations receive such generous treatment as did the ACC. Inconsistent rulings such as these from state courts on loosely defined educational exemptions do not offer much concrete guidance to taxpayers or to county tax officials.

### C. *The Charitable Exemption*

Sections 105-278.6 and 105-278.7 define “charitable purpose” as “one that has humane and philanthropic objectives; it is an activity that benefits humanity or a significant rather than limited segment of the community without expectation of pecuniary profit or reward” and includes “[t]he humane treatment of animals.”<sup>111</sup> That definition is nebulous at best and does little to help taxpayers and tax officials know exactly what activities would constitute the charitable use requirement of a property tax exemption. Reasonable people can disagree about what constitutes “humane and philanthropic” activity.

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athletic departments of the member schools. *See Atl. Coast Conference*, 112 N.C. App. at 7–8, 434 S.E.2d at 868–69. Some of those salaries are very large. Rick Pitino, the recently fired Louisville men's basketball coach, was paid \$7.76 million by the school and Adidas in 2016. *See* Jeff Greer, *Louisville's Rick Pitino Tops List of Highest-Paid NCAA Tournament Coaches*, COURIER J. (Louisville Mar. 29, 2017), <https://www.courier-journal.com/story/sports/college/louisville/2017/03/29/louisville-basketball-rick-pitino-salary-comparison-acc-coaches-usa-today-database/99771298/> [<https://perma.cc/B5RR-6L7M>].

109. The Guilford County tax office's online property record system indicates that the ACC owns real property worth \$2.75 million as of January 1, 2017, all of which is exempt from property taxes. Guilford Cty. Real Prop. Data, Parcel no. 0082729, The Atlantic Coast Conference, <http://taxweb.co.guilford.nc.us/CamaPublicAccess/PropertySummary.aspx?REID=0082729&pageIndex=0> [<https://perma.cc/6U58-BLM9>].

110. *Infra* Part III.C.

111. N.C. GEN. STAT. §§ 105-278.6(b), -278.7(f)(4) (2017). General Statutes section 105-278.6 covers a limited number of charitable organizations: YMCAs and similar organizations; homes for the aged and sick; orphanages; the Society for the Prevention of Cruelty to Animals; reformatories and correctional facilities; monasteries and convents; nonprofit first aid and rescue squads; and nonprofits providing low-income housing. *See id.* § 105-278.6(a). Section 105-278.7 is much broader, covering a variety of organizations, including charitable, historical, veterans, scientific, literary, benevolent associations or institutions, and “nonprofit community or neighborhood organization[s].” *Id.* § 105-278.7(c). In addition to charitable activities, the latter statute covers educational, scientific, and literary activities undertaken by qualifying property owners. *See id.* § 105-278.7(a).

Feeding and housing the poor would surely qualify, but what about encouraging a love of nature or generating economic activity in a depressed area? These are two potentially exempt purposes discussed in the case studies that follow.

Courts have offered little concrete guidance. While observing that “[t]he concept of charity is not confined to the relief of the needy and destitute,”<sup>112</sup> North Carolina courts have also made clear that a taxpayer cannot qualify for a charitable exemption simply because its activities are “laudable” or “desirable.”<sup>113</sup> Nor does the statute explain how much, if any, commercial activity a charitable organization may engage in before it loses its exclusion. For instance, should the million boxes of Girl Scout cookies sold each year by that organization affect its property tax exemptions in North Carolina?

#### *D. The Big Picture*

Regardless of the specific type of exemption involved, a similar question lies at the foundation of these North Carolina nonprofit property tax disputes: how much commercial activity may a nonprofit engage in before losing its exemption?

State legislators in North Carolina have taken notice. Legislators introduced a bill in the summer of 2017 to authorize additional local option sales taxes for municipalities in North Carolina, which they believed was partially justified in light of the reduction in local tax bases caused by acquisitions of private medical practices by nonprofit hospitals.<sup>114</sup> The 2017 bill would have required the North Carolina Department of Revenue to study “the existing property tax exemptions, exclusions, deferrals, and other benefits for the purpose of determining whether those benefits are needed or no longer serve the intended function and are, therefore, suitable for repeal.”<sup>115</sup> This study proposal strongly suggests that at least some legislators believe that existing property tax exemption law does not adequately respond to the trend of nonprofits’ increasing reliance on commercial activities.<sup>116</sup> The next section examines the continuing controversy

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112. *In re Chapel Hill Residential Ret. Ctr.*, 60 N.C. App. 294, 303, 299 S.E.2d 782, 788 (1983) (quoting *Cent. Bd. on Care of Jewish Aged, Inc. v. Henson*, 171 S.E.2d 747, 750 (Ga. Ct. App. 1969)) (denying charitable exemption to senior residential care facility because its residents paid market rent for their care).

113. *Id.* at 306, 299 S.E.2d at 789.

114. H.B. 900, Gen. Assemb., Reg. Sess. (N.C. 2017). This bill did not pass during the regular legislative session that adjourned in July 2017.

115. *Id.*

116. For more on the growing use of commercial activity to address social issues, see Marya Besharov, *The Line Between Non-Profit Has Become Increasingly Blurry*, QUARTZ

over nonprofit exemptions through the lens of several North Carolina cases.

### III. EXAMINING FIVE RECENT NORTH CAROLINA NONPROFIT EXEMPTION DISPUTES

The following case studies involve five very different types of nonprofits: a recreational/educational/scientific tourist attraction; a builder of homes for low-income residents; a private university; a community economic development organization; and a land conservation organization. But the exemption disputes involving these diverse nonprofits all focus on the same core issue of commercial activity that arose in the seminal *Elon College* case more than seventy-five years ago.<sup>117</sup> Similar questions needed to be answered in each dispute: How much commercial activity is too much before a nonprofit is no longer eligible for a property tax exemption? How connected must that commercial activity be to a nonprofit's exempt purpose? Can commercial activity itself be a valid exempt activity if it accomplishes a goal other than mere profit?

These case studies demonstrate a progression of increasing connection between a nonprofit's commercial activity and its exempt scientific, educational, and charitable purposes. We begin with an example of what seems to be pure commerce—gift shops and restaurants run by a nonprofit—with little connection to the nonprofit's exempt scientific and educational purposes other than the fact that the profit produced by those commercial activities help to fund those exempt activities. The next two cases involve commercial activity—a thrift store and a restaurant—that the nonprofits argue are intertwined with and necessary for their respective exempt charitable and educational purposes. They claim that the profit from the commercial activities is not an essential motivation; those activities are being conducted because they help further the organization's charitable or educational purpose. The fourth case study is a situation in which the nonprofit's commercial activity—the creation of jobs—is one and the same as its exempt charitable purpose. We end with an example where the alleged commercial activity—charging for tours of conservation land—is both related to the organization's exempt purpose and minimal in scope.

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(Mar. 14, 2016), <https://qz.com/637811/the-line-between-nonprofit-and-for-profit-has-become-increasingly-blurry/> [<https://perma.cc/M93H-JC69>].

117. As the analysis below makes clear, the *Elon College* case remains foundational in this area of law. See *infra* Part III.A–E.

We believe that the closer the connection between a nonprofit's commercial activity and its exempt purpose, the stronger the argument for a property tax exemption. North Carolina courts have danced around the importance of a nexus between commercial activity and exempt purposes, but they have never formally adopted it as an analytic approach. And, as our third case study demonstrates, courts sometimes fail to recognize what appears to be a clear and compelling nexus, one that we believe should be sufficient to justify a property tax exemption.

*A. Grandfather Mountain Stewardship Foundation, Inc.*

Grandfather Mountain, located in the Blue Ridge Mountain range, is one of the most popular tourist attractions in the state.<sup>118</sup> More than 250,000 people visit the mountain each year to enjoy its scenery and its miles of hiking trails.<sup>119</sup>

Those visitors also spend money—lots of it. Admission tickets for adults cost \$20, with total admission revenue exceeding \$4 million annually.<sup>120</sup> Once tourists make it past the admission gates, they can buy souvenirs at one of two gifts shops, snacks at the Fudge Shop, or a full meal at Mildred's Grill.<sup>121</sup> In 2010, combined food and gift sales at the mountain produced more than \$1.1 million in profit (not just revenue) each year.<sup>122</sup>

In other words, Grandfather Mountain is not just a big pile of dirt and rock. It is a big business, conducted on property worth nearly

118. The News and Observer ranked Grandfather Mountain the fifteenth most visited attraction in the state in 2017. See Abbie Bennett, *Here Are the Best Attractions In NC, Ranked. Half of the Top 10 Are in The Triangle*, NEWS & OBSERVER (Raleigh Mar. 6, 2018), <http://www.newsobserver.com/living/travel/article203736619.html> [<https://perma.cc/NQ95-Y7CE>].

119. See *id.* For annual attendance numbers and other facts and figures about Grandfather Mountain, see *Media FAQ*, GRANDFATHER MOUNTAIN, <https://grandfather.com/about-grandfather-mountain/media/media-faq/> [<https://perma.cc/32ZW-MA64>].

120. For a listing of current ticket prices, see *Grandfather Mountain Online Ticketing*, GRANDFATHER MOUNTAIN, <https://tickets.grandfather.com/Info.aspx?EventID=3> [<https://perma.cc/34QT-UGKP>]. The Grandfather Mountain Stewardship Foundation ("GMSF") reported revenues of \$4,015,273 from admissions and season passes in 2015. Grandfather Mountain Stewardship Found., Inc., IRS Form 990: Return of Organization Exempt From Income Tax, at 9, pt. VIII (OMB No. 1545-0047) (2015).

121. *Things To Do*, GRANDFATHER MOUNTAIN, <https://grandfather.com/things-to-do/> [<https://perma.cc/6QAG-KNLK>].

122. *In re Appeal of Grandfather Mountain Stewardship Found., Inc.*, 235 N.C. App. 561, 568, 762 S.E.2d 364, 368 (2014).

\$10 million.<sup>123</sup> But, perhaps surprisingly, this big business has been run by a nonprofit corporation, the Grandfather Mountain Stewardship Foundation, Inc. (“GMSF”), since 2009.<sup>124</sup> In 2010, GMSF sought to rely on its nonprofit status to exempt the entire Grandfather Mountain attraction from Avery County property taxes.<sup>125</sup> GMSF applied for exemptions under General Statutes

123. The attraction includes two parcels of land: one vacant lot appraised at \$230,000, and one larger parcel that includes shops and other buildings appraised at \$9.3 million. The annual real property tax bill for the attraction exceeds \$50,000. Avery Cty. Tax Office Bill No. 2017 009657, <http://webtax.averycountync.gov/TaxBill.aspx> [https://perma.cc/J4G7-E6C5 (staff-uploaded archive)] (last updated Dec. 14, 2017).

124. The Grandfather Mountain attraction is owned by Grandfather Mountain, Inc. (“GMI”), a for-profit company owned by GMSF, a nonprofit company. The ownership and operation of Grandfather Mountain is described in more detail in Avery County’s brief to the North Carolina Court of Appeals in *Grandfather Mountain*. See Brief for Respondent-Appellant at 3–5, *In re Appeal of Grandfather Mountain Stewardship Found., Inc.*, 235 N.C. App. 561, 762 S.E.2d 364 (2014) (No. COA13-1447), 2014 WL 675589 at \*3–5.

125. It’s unclear, for two reasons, whether the fact that legal title to the property was held by the for-profit GMI rather than by the nonprofit GMSF would disqualify it from property tax exemptions available only to nonprofit property owners. The North Carolina Court of Appeals expressed doubts about, but did not expressly reach, the ownership issue because it found that the use requirement was not satisfied. See *Grandfather Mountain*, 235 N.C. App. at 569–70, 762 S.E.2d at 369–70. The PTC concluded that GMSF was a qualifying owner because it leased the property from GMI under terms that placed “the burdens and obligations of ownership” on GMSF, which included the obligation to pay property taxes on the property. *Id.* at 569, 762 S.E.2d at 369. Normally, a leasehold interest does not satisfy the ownership requirement for property exemptions, but the PTC in this case assumed that it would. While that conclusion might not be defensible, in the authors’ view there was another, more solid legal reason why GMSF could qualify as the owner for purposes of property tax exemptions. The nonprofit, GMSF, owns GMI, the for-profit company that holds title to the property. North Carolina courts have been willing to “look through” title ownership by a subsidiary corporation and consider the parent corporation to be the true owner of record for purposes of property tax exemptions. See *In re Appeal of Fayette Place LLC*, 193 N.C. App. 744, 747, 668 S.E.2d 354, 357 (2008). In *Fayette Place*, the court concluded that a housing development was eligible for the government property exemption in section 105-278.1 despite the fact that the property was formally owned by a limited liability corporation, Fayette Place LLC, which, in turn, was owned by another nonprofit corporation, Development Ventures, Inc. *Id.* at 744–45, 668 S.E.2d at 355–56. This second corporation was owned and controlled by the Housing Authority of the City of the Durham, a quasi-public agency that qualifies for the government property exemption by statute. *Id.* The court concluded that

the possession of legal title is not determinative as to the question of ownership. Instead, this Court will focus its inquiry on the state’s interest in the property. Where the state possesses a sufficient interest in the property, such as equitable title to the property, the property is said to belong to the state even where legal title to the property is held by another party.

*Id.* at 747, 668 S.E.2d at 357 (citations omitted). The same reasoning presumably would apply to indirect ownership of property by a nonprofit seeking a scientific or charitable

sections 105-275(12), which covers land held for conservation purposes, and 105-278.7, the “catch-all” exemption that covers property used for educational, scientific, or charitable activities.<sup>126</sup>

Avery County denied GMSF’s initial exemption application, first through the county tax assessor, and then on appeal to its BOER.<sup>127</sup> But on appeal to the state PTC, GMSF prevailed.<sup>128</sup>

The PTC concluded that the property was used “wholly and exclusively” for scientific and charitable purposes despite the substantial amount of commercial activity at Grandfather Mountain’s gift shops, fudge shop, and restaurant.<sup>129</sup> Without all of those commercial sales, the PTC observed, it would be impossible for GMSF to continue its scientific and educational endeavors, such as guided hikes, a nature museum, and flora and animal conservation efforts.<sup>130</sup> “In both 2010 and 2011,” the PTC noted, “the Foundation operated at a loss . . . Private financial contributions in 2010 and 2011 were an insignificant portion of the Foundation’s revenue. The Foundation could not operate Grandfather Mountain if it had to rely solely on private financial contributions.”<sup>131</sup> In what appeared to be a blatant disregard of the venerable *Elon College* precedent,<sup>132</sup> the PTC focused on the use and importance of the *revenues* from the property rather than on the *actual use* of the property.<sup>133</sup>

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exemption, meaning that GMSF could qualify as the “owner” of Grandfather Mountain despite the fact that title to the property was held by GMI, its wholly-owned subsidiary.

126. *Grandfather Mountain*, 235 N.C. App. at 563, 762 S.E.2d at 365.

127. Grandfather Mountain Stewardship Found., Inc., 11 PTC 068, Findings of Fact no. 1 (N.C. Prop. Tax Comm’n June 24, 2013), <https://wayback.archive-it.org/194/20160406205931/http://www.dor.state.nc.us/taxes/property/decisions/scans/avery/Grandfather%20Mtn.%20Stewardship%20Found.%2011PTC068.pdf> [https://perma.cc/2JND-9SYT]. County assessors make the initial determinations on exemption applications, which can be appealed by the property owner to the county BOER. N.C. GEN. STAT. § 105-282.1(b) (2017). The BOER is comprised of either the county commissioners or a special board appointed by those commissioners. *Id.* § 105-322(a). If the application is denied by the BOER, the property owner may appeal to the PTC, a board that hears cases at the North Carolina Department of Revenue’s headquarters in Raleigh. *Id.* §§ 105-288(b), -290. Either party—the county or the property owner—may appeal a decision of the PTC to the state court of appeals. *Id.* §§ 7A-29, 105-345.

128. Grandfather Mountain Stewardship Found., Inc., 11 PTC 068 at Conclusions of Law no. 7.

129. *Id.* at Conclusions of Law no. 6.

130. *Id.* at Conclusions of Law no. 4.

131. *Id.* at Findings of Fact nos. 23–24.

132. *Rockingham Cty. v. Bd. of Trs. of Elon Coll.*, 219 N.C. 342, 346, 13 S.E.2d 618, 621 (1941).

133. Grandfather Mountain Stewardship Found., Inc., 11 PTC 068 at Conclusions of Law no. 4.

Later in its decision, the PTC brushed off the presence of the shops and restaurant as minor and irrelevant:

Any structures on the Real Property that are not used directly for educational and scientific purposes are incidental to the educational and scientific uses of the Real Property . . . . Neither the revenue used to fund these purposes nor the incidental use of buildings on the Real Property changes the primary purpose.<sup>134</sup>

Tellingly, the only structures the PTC mentioned in its opinion were “administrative offices, a maintenance building, a cabin, a woodworking shop, and a storage shed.”<sup>135</sup> Indeed, those buildings seem to be incidental to and necessary for the scientific and educational use of Grandfather Mountain. But the PTC ignored the gift shops, fudge shop, and restaurant on the property, which are primarily, if not exclusively, used for commercial activities rather than for scientific or educational activities.

The PTC’s ruling seemed to place far more weight on a conservation easement on the property that GMSF granted to the state in 2009 than on the actual activity on the property.<sup>136</sup> According to the PTC, the purpose of that easement was to “preserve Grandfather Mountain for future generations to learn about the diverse habitats, plants, and animals on Grandfather Mountain.”<sup>137</sup> The PTC noted in passing the fact that while this easement prohibited the expansion of current commercial activities on the property, it did not ban them entirely.<sup>138</sup> In other words, the GMSF could (and did) continue selling millions of dollars’ worth of souvenirs, fudge, and “Grandburgers” at Mildred’s Grill without violating the easement. The 2009 easement had no effect on how the property was used.

Given the questionable reasoning displayed by the PTC, Avery County was not willing to give up on the \$50,000 in annual property taxes levied on Grandfather Mountain without an extended fight. The county appealed the PTC’s ruling to the North Carolina Court of Appeals—and won.<sup>139</sup>

The North Carolina Court of Appeals agreed that there were sufficient scientific and educational activities at Grandfather

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134. *Id.* at Conclusions of Law nos. 5–6.

135. *Id.* at Findings of Fact no. 25.

136. *Id.* at Findings of Fact no. 11.

137. *Id.*

138. *See id.*

139. *In re* Appeal of Grandfather Mountain Stewardship Found., Inc., 235 N.C. App. 561, 570, 762 S.E.2d 364, 369 (2014).

Mountain.<sup>140</sup> But those activities, the court found, could not overcome the fact that Grandfather Mountain “operates to some extent as a for-profit tourist attraction.”<sup>141</sup> In a nutshell, the court concluded that the amount of commercial activities made it impossible for GMSF to prove that the property was “used wholly and exclusively for scientific or educational properties.”<sup>142</sup>

In particular, the court focused on the impact of the 2009 conservation easement on the property tax exemption question.<sup>143</sup> GMSF believed that this easement guaranteed that scientific and educational training would continue on the mountain, thereby justifying a property tax exclusion aimed at those uses.<sup>144</sup> But in the eyes of the court, the conservation easement was irrelevant for purposes of determining the property’s eligibility for a tax exclusion because the easement permitted extensive commercial activity on the property so long as that activity pre-dated the easement.<sup>145</sup>

The court observed,

[i]t appears, based on the observation of GMSF’s President, that GMSF was under the impression the conservation easement, by limiting the use of the property for conservation and educational activities, would also allow for the continuance of commercial activities. While that assumption may be valid for purposes of the easement and maintaining the 501(c)(3) status, it is not sufficient to withstand the requirements of N.C.G.S. §§ 105-275(12) and 105-278.7(a). Despite GMSF’s status as a 501(c)(3) nonprofit corporation and the conveyance of a conservation easement, the *use* of the property must still come within the scope and meaning of “wholly and exclusively used for educational and scientific purposes.”<sup>146</sup>

In other words, the exempt federal tax status of GMSF and the creation of a conservation easement that limited additional commercial activities could not justify a property tax exemption for property that was already used for substantial commercial activity.

As this analysis suggests, the authors agree with the North Carolina Court of Appeals’ legal reasoning. Based on well-established state law precedent, the undisputed substantial amount of

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140. *Id.* at 568–69, 762 S.E.2d at 368–69.

141. *Id.* at 569, 762 S.E.2d at 369.

142. *Id.* at 570, 762 S.E.2d at 369.

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.*

commercial activity on Grandfather Mountain should prevent the property from qualifying for a property exemption. The result in *Elon College* seemed to demand such a denial.<sup>147</sup> That case made clear that the use of property, not the use of the revenue from the property, is determinative for property tax exemption eligibility.<sup>148</sup> The fact that GMSF might not be able to provide its scientific and educational offerings without its gift shops and food sales is irrelevant under North Carolina law.

But is that the right result from a policy perspective? Grandfather Mountain is a wonderful public resource and GMSF uses that property (in part) to offer the public valuable scientific and educational programming. GMSF should not be penalized by the loss of a property tax exemption due to its commercial activities when (1) those activities fund the site's scientific and educational programming—without admission tickets, gift shops, and restaurants, GMSF could not survive, and (2) those commercial activities are all conducted in direct proximity to its scientific and educational offerings.<sup>149</sup> If a property owner uses a portion of its property for commercial activity to fund scientific and educational opportunities elsewhere on its property that are generally viewed as a public good, then, perhaps, property tax law should not penalize the taxpayer with the loss of its property tax exemption due to that commercial activity.

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147. *Rockingham Cty. v. Bd. of Trs. of Elon Coll.*, 219 N.C. 342, 346, 13 S.E.2d 618, 621 (1941).

148. *See id.*

149. Federal law requires nonprofit organizations to pay unrelated business income tax (“UBIT”) on profits arising from commercial activity not directly in furtherance of their exempt purposes. *See* I.R.C. § 513(a) (2012). However, the law includes a “convenience exception,” which exempts unrelated business income if the commercial activity is carried on “primarily for the convenience of its members, students, patients or employees.” *See id.* § 513(a)(2); Treas. Reg. § 1.513-1(e)(2) (as amended in 1983). For example, a hospital cafeteria that serves employees, patients, and their families would fall under this exception. While not labeled a “convenience exception,” North Carolina property tax law also exempts some commercial activity that is deemed reasonably necessary to the owner’s exempt purpose. For example, the educational exemption covers not only classrooms, but also reaches student housing and dining facilities even if they are patronized by the general public. N.C. GEN. STAT. § 105-278.4(f)(2) (2017). Similarly, the North Carolina Court of Appeals extended the charitable hospital property tax exemption in section 105-278.8 to cover a charitable hospital’s extended-hour daycare center after concluding that the center was crucial to the hospital’s ability to retain employees and, therefore, was reasonably necessary for its exempt purpose. *In re Moses H. Cone Mem’l Hosp.*, 113 N.C. App. 562, 578–79, 439 S.E. 2d 778, 787 (1994), *aff’d in part, cert. dismissed as improvidently granted in part*, 340 N.C. 93, 455 S.E.2d 431 (1995). The *Grandfather Mountain* court did not address the “reasonably necessary” principle in its analysis, most likely because it would have been difficult for GMSF to argue with a straight face that its fudge shop and souvenir stores were necessary for its scientific and educational purposes.

While the legal analysis at issue in *Grandfather Mountain* is the same as applied in the *Elon College* case, the facts are very different. Elon College's commercial activity was unconnected to its educational activities, both geographically and substantively. Elon College was acting in a similar manner to other commercial landlords in Reidsville, which is over twenty miles away from its campus.<sup>150</sup> The clients renting out space in Elon College's office building had no connection to Elon College's educational activities.<sup>151</sup>

In contrast, the people spending money on Grandfather Mountain are the same people who are benefitting from GMSF's scientific and educational programming. As compared to *Elon College*, it is more difficult to argue that the gift shops and restaurants at the top of Grandfather Mountain are competing with those in nearby Boone and Banner Elk. Should the property tax system recognize the difference between commercial activity that is completely unrelated to exempt purposes, as in *Elon College*, and commercial activity that is somewhat related to exempt purposes, as in *Grandfather Mountain*? The next case study provides an example of an even closer connection between a nonprofit's commercial activity and its exempt purpose.

#### B. *Habitat for Humanity*

Habitat for Humanity ("Habitat") is known for building homes for low-income residents across the country and across the globe.<sup>152</sup> Without question, the property Habitat uses to administer its home-building efforts would qualify for charitable property tax exemptions in North Carolina.<sup>153</sup>

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150. See *Elon Coll.*, 219 N.C. at 343, 13 S.E.2d at 619; *Driving Directions from Elon University to Reidsville, North Carolina 27320*, GOOGLE MAPS, <https://www.google.com/maps/> [<https://perma.cc/3FZJ-62ZX>] (showing that Reidsville is roughly twenty-three miles from the campus of Elon College, now Elon University).

151. See *Elon Coll.*, 219 N.C. at 347, 13 S.E.2d at 622.

152. Habitat for Humanity operates in more than 1,400 communities across the United States and in 70 countries worldwide. See *Frequently Asked Questions*, HABITAT FOR HUMANITY, <https://www.habitat.org/about/faq#where> [<https://perma.cc/6YBL-GP6N>].

153. General Statutes of North Carolina section 105-278.6(a)(8) exempts property that is owned by a "nonprofit organization providing housing for individuals or families with low or moderate incomes" and used for that purpose. N.C. GEN. STAT. § 105-278.6(a)(8) (2017). The more general charitable exemption created by section 105-278.7 could also apply to Habitat's property used for the construction of low-income housing. *Id.* The PTC decision in a case involving Habitat, discussed in detail below, states that Habitat sought an exemption under the latter statute. Thanks to the overlap between those statutes, the same analysis would apply regardless of which of the two exemptions Habitat requested.

Habitat also operates more than 850 “ReStores” across the United States.<sup>154</sup> Habitat describes its ReStores as “nonprofit home improvement stores and donation centers that sell new and gently used furniture, appliances, home accessories, building materials and more to the public at a fraction of the retail price.”<sup>155</sup> Independently owned and operated by local Habitat for Humanity organizations, the ReStores produce revenue that is “used to help build strength, stability, self-reliance and shelter in local communities and around the world.”<sup>156</sup>

Should Habitat’s ReStores benefit from the same charitable property tax exemptions that apply to the property Habitat uses for low-income housing construction? Mecklenburg County argued they should not.<sup>157</sup>

In 2006, the county denied Habitat’s request for a charitable exemption for one of its ReStores located in and around Charlotte.<sup>158</sup> The property was used as more than just a ReStore; Habitat also located its local corporate offices and housing for Habitat volunteers on the site.<sup>159</sup> On appeal to the county BOER, Habitat prevailed, but only partially.<sup>160</sup> Relying on the statutory authority for partial exemptions, the BOER determined that thirty percent of the property—the portions used for corporate headquarters and volunteer housing—should be exempt.<sup>161</sup> The BOER determined that the remaining seventy percent of the property, all of which was used for a ReStore, should be taxable.<sup>162</sup> The total tax value of the property was \$2.7 million, which meant that, under the BOER’s decision, Habitat would have been liable for property taxes on

154. *Volunteer at a Habitat for Humanity Restore*, HABITAT FOR HUMANITY, <https://www.habitat.org/restores/volunteer> [https://perma.cc/RW54-6WLE].

155. *See Habitat for Humanity ReStore*, HABITAT FOR HUMANITY, <https://www.habitat.org/restores> [https://perma.cc/Q3VR-74YU].

156. *Id.*

157. *In re* Habitat for Humanity of Charlotte, 06 PTC 242 (N.C. Prop. Tax Comm’n May 11, 2007), <https://wayback.archive-it.org/194/20160406211017/http://www.dor.state.nc.us/taxes/property/decisions/scans/mecklenburg/Habitat%20for%20Humanity%20of%20Char.,%2006PTC242,%20Order%20&%20Final%20Dec.pdf> [https://perma.cc/NTY5-9HRV].

158. *Id.*; *see also* *Where We Build—Local ReStore Search Results*, HABITAT FOR HUMANITY, <https://www.habitat.org/local/restore?zip=28204> [https://perma.cc/4PC8-PURZ (staff-uploaded archive)] (showing the number of stores in the Charlotte area).

159. *Habitat for Humanity of Charlotte*, 06 PTC 242 at Findings of Fact nos. 4–6.

160. *Id.* at Findings of Fact no. 9.

161. *Id.*

162. *Id.* at Statement of the Case and Facts.

property valued at roughly \$1.9 million.<sup>163</sup> That would have produced a 2006 tax bill for Habitat of about \$24,000.<sup>164</sup>

That bill was too much for Habitat to swallow, apparently, as the organization appealed the Mecklenburg County BOER decision to the state PTC.<sup>165</sup> Habitat asked the PTC to exempt the entire property, arguing that its ReStore should be considered charitable.<sup>166</sup> According to Habitat, the ReStore serves as “the main intake point for constructions materials and household furnishings donated by local residents and businesses” and is the site on which donated materials are sorted by Habitat staff and volunteers to determine what items will be used in Habitat’s construction projects.<sup>167</sup> The ReStore also serves as a volunteer opportunity for Habitat homebuyers who are unable to assist with the construction of their homes due to physical or mental limitations.<sup>168</sup>

After considering this evidence, the PTC concluded that “the entire property is being used for a charitable purpose” and, therefore, should be completely exempt from property taxes.<sup>169</sup> According to the PTC, the “incidental availability of the facility to the general public”—in other words, the commercial sales occurring at the ReStore—was insufficient to prevent the property from qualifying for a charitable exemption.<sup>170</sup> Mecklenburg County disagreed, of course,

163. *Id.*

164. See Mecklenburg Cty., *2006 Tax Rates*, MECKNC.GOV, <https://www.mecknc.gov/TaxCollections/AdValoremRates/2006%20Tax%20Rates.pdf> [https://perma.cc/5JM7-8C6D]. The Combined City/County Rate was \$1.2775, which is expressed as “tax per \$100” of taxable value. *Id.* The tax bill is calculated by dividing the tax value (\$1.9 million in this case) by 100 and then multiplying the result by the combined rate. *Id.*

165. *Habitat for Humanity of Charlotte*, 06 PTC 242 at Statement of the Case and Facts.

166. *Id.* at Findings of Fact no. 10.

167. *Id.* at Findings of Fact no. 6.

168. *Id.* at Findings of Fact no. 7. As described on the Habitat for Humanity website, “Habitat affiliates require only a small down payment [from home buyers] because few low-income families can afford more than that. Instead, partner families are required to contribute sweat equity.” See *What Is Sweat Equity?*, HABITAT FOR HUMANITY, <https://www.habitat.org/stories/what-is-sweat-equity> [https://perma.cc/T27C-T3AE]. Home buyers can invest the required “sweat equity” by working on the construction site, in a ReStore, or in the Habitat administrative offices. *Id.*

The PTC also considered testimony indicating that all of the net proceeds from ReStore sales are used to construct homes for low-income families. *Habitat for Humanity of Charlotte*, 06 PTC 242 at Findings of Fact no. 8. While this fact should not be relevant to the eligibility for a property tax exemption under the reasoning of *Elon College*, it is possible that the finding affected the PTC’s decision to exempt the entire ReStore. *Rockingham Cty. v. Bd. of Trs. of Elon Coll.*, 219 N.C. 342, 346, 13 S.E.2d 618, 621 (1941).

169. *Habitat for Humanity of Charlotte*, 06 PTC 242 at Findings of Fact no. 10 & Conclusions of Law no. 5.

170. *Id.* at Conclusions of Law no. 5.

but after unsuccessfully petitioning the PTC to reconsider the case, the county declined to seek an appeal in state court.<sup>171</sup> Did the PTC get this one right? The authors think so, although this case is a close call.

In general, a thrift store or second-hand store operated by a nonprofit is commercial activity that, under the *Elon College* and *Grandfather Mountain* line of cases, should not qualify as an exempt use of the property.<sup>172</sup> If the office building rented out by Elon College and the gift shop run by Grandfather Mountain were taxable commercial activities, surely the sale of donated bikes, couches, and dining room tables by Habitat should also be a taxable activity. The fact that the revenue from the ReStore supports the building of low-income housing should be irrelevant, just as it was irrelevant that the income from the office building rental and the gift shop sales were put to exempt educational or scientific uses by Elon College and Grandfather Mountain, respectively.

However, unlike those two property owners, Habitat was able to argue that it was not just the *revenue* from its commercial activity that was key to its charitable activities but also the *substance* of those activities. In other words, the ReStore was not just a store. It was where Habitat processed and stored donations that might be used in its low-income housing construction. It was where Habitat home buyers who could not work on construction sites invested their sweat equity. There was nothing about the operation of the office building rented out by Elon College that connected it to the college's educational mission. Nor did the shops and restaurants on Grandfather Mountain relate to the scientific and educational activities offered elsewhere on the mountain.

It seems reasonable to exempt property that is used for commercial activity so long as the nonprofit owner can demonstrate that the commercial activity has a substantive nexus with its exempt purpose beyond mere revenue production. That is what the North Carolina Court of Appeals did when it granted an exemption to property used as a daycare center by a nonprofit charitable

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171. *See id.* at Order (denying Mecklenburg County's appeal of May 11, 2007, decision on September 17, 2007).

172. It is worth noting that under federal law, such activities would be explicitly exempt from unrelated business income tax. *See* I.R.C. § 513(a)(3) (2012); Treas. Reg. § 1.513-1(e)(3) (as amended 1983). Where a nonprofit organization's business consists of selling of merchandise to the general public, that business will be exempt from corporate income taxation if substantially all of that merchandise has been donated to the organization. This is the exception that permits charitable thrift stores to operate free of federal income tax obligations. *See* § 1.513-1(e)(3).

hospital.<sup>173</sup> Although the daycare center charged market rates and was clearly engaging in commercial activity, the court concluded that it should be considered an exempt use because it was directly related to the unique needs of the charitable hospital: it was available only to hospital employees and was open until midnight seven days a week.<sup>174</sup> The hospital argued that it could not attract sufficient qualified employees if it did not offer this unique childcare option.<sup>175</sup> The nexus between the daycare center and the hospital's exempt purpose was substantive and not merely financial.

Alas, the law in this area is not always consistent. As the next case proves, sometimes a substantive nexus between a nonprofit's commercial activity and its exempt purpose is not enough to justify an exemption.

*C. University for the Study of Human Goodness and Creative Work*

Another recent North Carolina property tax case illustrates the uncertain terrain confronting nonprofit organizations that stray into the commercial realm. The University for the Study of Human Goodness and Creative Group Work ("University"), located in Forsyth County, was an educational organization exempt from federal taxation under Internal Revenue Code section 501(c)(3) and was established to promote "community service and group work."<sup>176</sup> Its curriculum, which required one year to complete and ended with the awarding of a certificate, was divided into four different tracks and included opportunities to learn about "entrepreneurship, group work, and communication."<sup>177</sup>

Several aspects of the organization's approach to education were unconventional. It was not accredited by any other organization, did not enroll full-time students, did not operate on the "semester system," and did not issue grades.<sup>178</sup> Further, its educational goals were arguably diffuse. For example, they included "learn[ing]

173. *In re Moses H. Cone Mem'l Hosp.*, 113 N.C. App. 562, 578–79, 439 S.E.2d 778, 787 (1994), *aff'd in part, cert. dismissed as improvidently granted in part*, 340 N.C. 93, 455 S.E.2d 431 (1995).

174. *Id.* at 574, 439 S.E.2d at 784–85.

175. *Id.* at 575, 439 S.E.2d at 785.

176. *In re Univ. for Study of Human Goodness & Creative Grp. Work*, 159 N.C. App. 85, 85–86, 582 S.E.2d 645, 646 (2003).

177. *Id.* at 86, 582 S.E.2d at 646.

178. *In re Appeal of Univ. for Study of Human Goodness & Creative Grp. Work*, 00 PTC 304, Findings of Fact nos. 4–5 (N.C. Prop. Tax Comm'n Jan. 16, 2002), <https://wayback.archive-it.org/194/20160406210657/http://www.dor.state.nc.us/taxes/property/decisions/scans/forsyth/Univ.%20for%20the%20Study%20of%20Human%20Goodness%2000PTC304.pdf> [https://perma.cc/2JDK-Z4GH].

techniques in human goodness, by training the students to serve others.”<sup>179</sup> In addition to a curriculum that might sound like hippy nonsense to conventional ears, the University’s pedagogical approach relied in part on experiential learning,<sup>180</sup> which is what led to issues with the Forsyth County Tax Administrator.

As part of its experiential curriculum, the University purchased a restaurant that was located not on its campus, but “six [] miles from the [university’s] housing and classroom facilities.”<sup>181</sup> Once complete, the restaurant ran as a going concern serving food to the general public and charging commercial rates.<sup>182</sup> Students and faculty from the University, who spent a year renovating the property on a volunteer basis, linked their “entrepreneurial” experiences at the restaurant to their classroom discussions.<sup>183</sup> According to a spokesperson for the University, there was no profit motive in establishing the restaurant; its only purpose was to act as a “training laboratory” to teach “techniques in human goodness by training the students to serve others.”<sup>184</sup> In its first year in operation, the restaurant produced excess revenues of \$200,000, which the University used to pay down its debt on the building and contribute to other charities.<sup>185</sup>

Before turning to an account of the legal proceedings, it is worth reiterating several factual aspects of the case. First, the University had qualified for exempt status under federal law.<sup>186</sup> Indeed, it is not uncommon for bona fide 501(c)(3) educational organizations to eschew the semester system and grades and rely heavily on experiential learning. In fact, those three characteristics apply to Northeastern University, where Tom studied law.<sup>187</sup> There also are numerous examples of renowned educational organizations that incorporate unconventional businesses into their educational

179. *Id.* at Statement of Facts.

180. *See id.* at Findings of Fact no. 4.

181. *Id.* at Findings of Fact no. 6.

182. *Id.* at Findings of Fact no. 7.

183. *In re Univ. for Study of Human Goodness & Creative Grp. Work*, 159 N.C. App. 85, 86, 582 S.E.2d 645, 647 (2003).

184. *Univ. for Study of Human Goodness*, 00 PTC 304 at Statement of Facts; *see also Univ. for Study of Human Goodness*, 159 N.C. App. at 86, 582 S.E.2d at 647 (describing the learning objectives of the restaurant as “leadership, communication, time management, [and] money management, every single day”).

185. *Univ. for Study of Human Goodness*, 159 N.C. App. at 86, 582 S.E.2d at 647.

186. *Id.* at 85–86, 582 S.E.2d at 646.

187. *See generally About*, NE. U. SCH. L., <https://www.northeastern.edu/law/about/index.html> [<https://perma.cc/NL5A-B3UA>] (explaining the school’s experiential and collaborative approach to legal education, including a lack of letter grades).

programs. Consider Deep Springs College in the mountains of California, where students run a cattle ranch while studying toward their degrees.<sup>188</sup> Nor is it unheard of for educational and charitable organizations to use restaurants as teaching venues. To take one example, Tom helped obtain 501(c)(3) status for a fast food restaurant that was loosely affiliated with a school of public health. The goal was to locate the restaurant in a low-income “food desert” and teach local residents about nutritious, inexpensive food options.<sup>189</sup>

Finally, nothing in the facts of this case indicated that any individual or group was attempting to run a scam. There were no allegations that this was a for-profit enterprise in disguise, that the principal actors were skimming money or paying themselves excessive salaries, or even that the restaurant was a veiled effort to use a commercial operation to cross-subsidize the University’s educational program.

In spite of federal law’s tolerance for unconventional curricula and experiential learning among educational organizations, when the University requested a property tax exemption for its restaurant, the Forsyth County Tax Administrator, and on appeal Forsyth County’s BOER, rejected it<sup>190</sup> on grounds that the organization failed to show that the restaurant property was “[of] a kind commonly employed in the performance of those activities naturally and properly incident to the operation of an educational institution . . . .”<sup>191</sup> The North Carolina Property Tax Commission, and later the North Carolina Court of Appeals, relied on the testimony of an “expert in the field of education and accreditation” who testified that “there was no evidence of curriculum, learning outcomes, or measurement of outcomes.”<sup>192</sup> The expert also testified that working in a restaurant is not educational unless the students at issue are studying toward a degree related to restaurants.<sup>193</sup>

In the authors’ view, the University and its restaurant, though unconventional, met the definition of “educational” under North

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188. See *What Is Deep Springs?*, DEEP SPRINGS COLL., <http://www.deepsprings.edu/> [<https://perma.cc/F83T-A63C>].

189. Memorandum from Thomas Kelley, Professor, Univ. of N.C. Sch. of Law, to the N.C. Law Review (May 21, 2018) (on file with the North Carolina Law Review).

190. *Univ. for Study of Human Goodness*, 00 PTC 304 at Conclusion of Law no. 8.

191. N.C. GEN. STAT. § 105-278.4(a)(3) (2017).

192. *In re Univ. for Study of Human Goodness & Creative Grp. Work*, 159 N.C. App. 85, 87, 582 S.E.2d 645, 647 (2003).

193. *Id.*

Carolina property tax law.<sup>194</sup> The testimony by the educational expert, upon which the PTC and the Court of Appeals relied, was simply wrong, particularly about the fact that a restaurant cannot be a legitimate tool for education unless the students are studying restaurants. What about the fast food restaurant, described above, which teaches about healthy nutrition? To take another example, what about a restaurant that is owned and operated by a long-term drug rehabilitation center where the educational objectives focus not on restaurant skills, but on “soft skills,” such as showing up to work on time, dressing appropriately for the workplace, and speaking clearly to customers while looking them in the eye?<sup>195</sup> Both of those restaurants should be considered educational, and both should qualify for property tax exemptions under state law. We suspect that what was really going on in this case is that the decision makers relied on *ad hoc* judgments about what they believed were and were not worthwhile educational activities and decided that teaching human goodness did not qualify.

*D. EmPOWERment Inc.*

EmPOWERment, Inc.’s recent property tax exemption dispute with Orange County<sup>196</sup> illustrates how difficult it can be for a nonprofit to prove that its commercial activities are directly related to and vital for its exempt purposes. It also provides an example of North Carolina tax assessors’ ambivalence toward property owned by charities, but used in ways that emit a whiff of commercialism.

EmPOWERment, Inc. is a nonprofit community development corporation located in the Midway Business District,<sup>197</sup> a historically African American area<sup>198</sup> that straddles the line between Chapel Hill

194. Section 105-278.4(f)(1) of the General Statutes of North Carolina defines “educational purpose” as a purpose that “has as its objective the education or instruction of human beings; it comprehends the transmission of information and the training or development of the knowledge or skills of individual persons.” N.C. GEN. STAT. § 105-278.4(f)(1) (2017).

195. This example is similar to the commercial activities undertaken by TROSA, a substance abuse recovery programs discussed in detail below. *See infra* Part IV.A.

196. *In re Appeal of EmPOWERment, Inc.*, 07 PTC 381 (N.C. Prop. Tax Comm’n May 18, 2009), <https://wayback.archive-it.org/194/20160406211250/http://www.dor.state.nc.us/taxes/property/decisions/scans/orange/EMPOWERMENT%20Inc%2007PTC381.pdf> [<https://perma.cc/7R6H-PLVF>].

197. *Id.*

198. *See* Janna Childers, *Black Entrepreneurship in Chapel Hill*, DAILY TAR HEEL, (Chapel Hill Nov. 24, 2015, 2:22 PM), <http://www.dailytarheel.com/article/2015/11/black-entrepreneurship-in-chapel-hill> [<http://perma.cc/2FNA-5AC2>] (referring to Midway as a historic center of African-American entrepreneurship).

and Carrboro.<sup>199</sup> The district is closely associated with a nearby historically African American residential area known as Northside.<sup>200</sup> EmPOWERment owns and operates the Midway Business Center, a business incubator that seeks to start, nurture, and ultimately launch private businesses owned and operated by racial minorities, women, and low- and moderate-income individuals.<sup>201</sup> EmPOWERment's dispute with Orange County concerned the portion of its real estate devoted to the business incubator.<sup>202</sup>

The Midway Business Center accomplished its goals by providing entrepreneurs with attractive office space along with common access to meeting rooms and equipment, such as copy and fax machines.<sup>203</sup> Crucially, the Center also provided an on-site educational program that included business-planning workshops, a manager who met regularly with the entrepreneurs to discuss their progress, and a series of business-related seminars.<sup>204</sup> The Center kept rent as low as possible to accommodate entrepreneurs who could not afford the costs of renting in Chapel Hill and Carrboro; however, it also endeavored to operate on a "self-sustaining basis."<sup>205</sup>

There is no doubt that EmPOWERment, Inc., including its Midway Business Center, qualifies for federal tax exempt status under Internal Revenue Code section 501(c)(3).<sup>206</sup> Under federal law, it has long been settled that community economic development programs—even those that intend to stimulate for-profit businesses—count as charitable so long as intended program beneficiaries fall into a charitable class, typically the poor and distressed or individuals and

199. *Id.*

200. *What is Northside?*, MARIAN CHEEK JACKSON CTR., <https://jacksoncenter.info/northside-stories/the-history-of-northside/> [<http://perma.cc/2YZF-WWNK>].

201. *EmPOWERment, Inc.*, 07 PTC 381 at Findings of Fact no. 8.

202. *Id.* at Findings of Fact no. 2.

203. *Id.* at Findings of Fact no. 5.

204. *Id.*

205. *Id.* at Findings of Fact no. 9.

206. *Charitable Organization*, N.C. SEC'Y OF STATE, [https://www.sosnc.gov/online\\_services/search/Charities\\_Results](https://www.sosnc.gov/online_services/search/Charities_Results) [<http://perma.cc/DN7Q-ZRXQ> (staff-uploaded archive)] (listing EmPOWERment, Inc. as a 501(c)(3) organization). The IRS's "Exempt Organizations Select Check" (an e-database on nonprofit organizations) lists EmPOWERment, Inc. as an approved public charity. *Results from Tax Exempt Organization Search*, INTERNAL REVENUE SERV., [https://apps.irs.gov/app/eos/pub78Search.do;jsessionid=KvZ7iAU6GZI5tlzEPLpTQ\\_\\_?ein1=&names=Empowerment&city=Chapel+Hill&state=NC&country=US&deductibility=all&dispatchMethod=searchCharities&submitName=Search](https://apps.irs.gov/app/eos/pub78Search.do;jsessionid=KvZ7iAU6GZI5tlzEPLpTQ__?ein1=&names=Empowerment&city=Chapel+Hill&state=NC&country=US&deductibility=all&dispatchMethod=searchCharities&submitName=Search) [<http://perma.cc/5UF7-L9JW>].

communities that have suffered the effects of past discrimination.<sup>207</sup> Also, as discussed in Part I above, federal law gives charitable organizations such as the Midway Center leeway to charge for their services, particularly where those services are directly in furtherance of the charitable mission,<sup>208</sup> so federal law would make no objection to a business incubator asking its tenants to pay rent.

EmPOWERment's leaders were surprised and dismayed, therefore, when they received a property tax bill from Orange County that amounted to several thousand dollars annually.<sup>209</sup> They learned that Orange County's tax assessors had determined that the Midway Center property, although owned by a charitable organization, was being used for a commercial and, therefore, not a "wholly and exclusively" charitable purpose.<sup>210</sup>

During the first go-round in 2004, EmPOWERment, Inc. appealed its loss of exemption to the Orange County BOER. That appeal, which Tom attended, resulted in an affirmation of the county assessor's decision to deny the exemption.<sup>211</sup> EmPOWERment's next step was to appeal to the North Carolina PTC, where four commissioners (one being absent) split in a two-to-two decision, effectively sustaining Orange County's decision.<sup>212</sup> Faced with the prospect of paying a law firm to take its case to the North Carolina Court of Appeals, EmPOWERment decided to regroup and explore other strategies for reducing its tax bill.<sup>213</sup>

The alternative strategies failed, and, in 2007, EmPOWERment again appealed Orange County's decision. The organization again lost at the Orange County BOER but prevailed at the state PTC.<sup>214</sup> The majority defined the question before the commission as whether the Midway property was used wholly and exclusively for educational or charitable purposes.<sup>215</sup> Referring explicitly to statutory definitions of

207. See generally Rev. Rul. 74-587, 1974-2 C.B. 162 (ruling that community economic development organizations that serve low-income, minority, and other disadvantaged communities qualify as charitable under Section 501(c)(3)).

208. See *supra* notes 24–27 and accompanying text.

209. We base this characterization about EmPOWERment, Inc.'s initial discovery of its unexpected tax burden on Tom's first-hand experience interacting with its leaders when they received the property tax bill in approximately 2004.

210. Memorandum from Thomas Kelley, Professor, Univ. of N.C. Sch. of Law, to the N.C. Law Review (May 21, 2018) (on file with the North Carolina Law Review).

211. *Id.*

212. *Id.*

213. *Id.*

214. *EmPOWERment, Inc.*, 07 PTC 381.

215. *Id.* at Statement of the Case.

the terms “educational purpose”<sup>216</sup> and “charitable purpose,”<sup>217</sup> the commission found that EmPOWERment should have prevailed on both grounds.<sup>218</sup>

As evidence that EmPOWERment’s property use was charitable, the PTC pointed to the fact that the tenants in the organization’s Midway Business Center were individuals who were unable to obtain office space in nearby alternative locations; that the organization endeavored to keep rents as low as possible; that the majority of new jobs coming out of the center went to low- and moderate-income people; and that the full range of center services were provided primarily for the benefit of minorities, women, and lower-income people.<sup>219</sup> As evidence that EmPOWERment’s use was educational, the PTC pointed to the organization’s educational programs that “maximize[d] the number of successful businesses graduating from the incubator.”<sup>220</sup>

The authors think that the PTC reached the correct decision. EmPOWERment is engaged in commercial activity, but that activity is directly in furtherance of its charitable and educational mission. If its business incubator was operated with even the partial hope of seeding high-growth technology companies that would help stimulate economic development in the community, the organization would not deserve a charitable property tax exemption because assisting established and successful business owners grow their businesses is not a charitable activity. However, helping low-income and minority people get their foot on the bottom rung of society’s economic ladder is charitable, and any activity—including commercial activity—undertaken solely in pursuit of that goal meets the relevant state law definitions of charity, and, thus, should be exempt from property taxation.

The EmPOWERment property satisfies the analysis required by the landmark *Elon College* case because the nonprofit engages in its business incubator activities without the expectation of “pecuniary

216. *Id.*; see also N.C. GEN. STAT. § 105-278.7(f)(1) (2017).

217. *EmPOWERment, Inc.*, 07 PTC 381 at Conclusions of Law no. 3. Section 105-278.7(f)(4) of the General Statutes of North Carolina defines “charitable purpose” as a purpose “that has humane and philanthropic objectives; it is an activity that benefits humanity or a significant rather than limited segment of the community without the expectation of pecuniary profit or reward . . . .” N.C. GEN. STAT. § 105-278.7(f)(4) (2017).

218. *EmPOWERment, Inc.*, 07 PTC 381 at Conclusions of Law nos. 4–5.

219. *Id.* at Findings of Fact nos. 7–9.

220. *Id.* at Findings of Fact no. 8.

profit or reward.”<sup>221</sup> Despite its seemingly commercial nature, the activities are undertaken in furtherance of a charitable purpose and, therefore, are not “thrust into the business life of the community.”<sup>222</sup> Unlike Elon College’s office building rentals or Grandfather Mountain’s gift shops, profit is not what motivates EmPOWERment’s commercial activity. The commercial activity at issue with EmPOWERment, renting office space to minority and low-income entrepreneurs, is indivisible from EmPOWERment’s charitable and educational exempt purpose of promoting local minority- and low-income-owned businesses and employment. It is impossible to separate them.

Equally important, EmPOWERment was not charging market-rate rents for its space. It kept prices affordable for low-income entrepreneurs. North Carolina courts have made clear that even when a nonprofit is engaged in activity deemed beneficial to society, it cannot expect to obtain a property tax exemption if it is charging market rates and making a profit on that activity.<sup>223</sup> While PTC decisions are not binding on state courts,<sup>224</sup> the result in the EmPOWERment case evidences that nonprofits will not risk losing their tax exemptions merely for charging moderate fees for their charitable and educational activities.

The real question here is: why was it so difficult and time consuming to arrive at what seemed to be a relatively obvious interpretation of North Carolina law? It is unfortunate that EmPOWERment was compelled to pay many thousands of dollars in property taxes to Orange County between 2004 and 2007 and compelled to expend significant resources to argue in favor of a position that should have been obvious to anyone looking carefully. Many nonprofit organizations would not have the resources and determination for such an extended fight and would either suffer under the burden of unanticipated taxation or, in some cases, go out

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221. § 105-278.7(f)(4); *see also* Rockingham Cty. v. Bd. of Trs. of Elon Coll., 219 N.C. 342, 346, 13 S.E.2d 618, 621 (1941).

222. *Elon Coll.*, 219 N.C. at 346, 13 S.E.2d at 621.

223. *See In re Appeal of Eagle’s Nest Found.*, 194 N.C. App. 770, 778, 671 S.E.2d 366, 371 (2009) (denying property tax exemption for a nonprofit foundation’s summer camp site under section 105-278.7 of the General Statutes of North Carolina, despite community-oriented goals, based in part on the fact that it charged market rate for its camps, made several hundred thousands of dollars in profit and spent only two percent of its revenue on financial aid for low-income campers).

224. *See Brock v. N.C. Prop. Tax Comm’n*, 290 N.C. 731, 737, 228 S.E.2d 254, 258 (1976).

of business.<sup>225</sup> Thus, although EmPOWERment ultimately succeeded, its struggle illustrates North Carolina's current property tax exemption conundrum.

The next case study provides another example of an assessor taking a dim view of a nonprofit's commercial activities despite substantive ties between those activities and the nonprofit's charitable goals. As is true with the EmPOWERment case, the end result was a property tax exemption, but the nonprofit was forced to fight tooth-and-nail to achieve that result—inappropriately, in the authors' view.

### *E. Southern Appalachian Highlands Conservancy*

Southern Appalachian Highlands Conservancy's ("SAHC") recent dispute with Buncombe County, North Carolina, over a charitable property tax exemption illustrates how county tax officials too often take an overly narrow view of what activities should qualify for a charitable property tax exemption.

SAHC is a tax-exempt nonprofit under Internal Revenue Code section 501(c)(3)<sup>226</sup> whose mission is to "conserve the unique plant and animal habitat, clean water, farmland, scenic beauty, and places for people to enjoy outdoor recreation in the mountains of North Carolina and Tennessee for the benefit of present and future generations."<sup>227</sup> The organization works toward those goals by "forging and maintaining long-term conservation relationships with private landowners and public agencies, owning and managing land and encouraging healthy local communities."<sup>228</sup> SAHC has protected more than 70,000 acres in the North Carolina mountains through conservation easements and land purchases, and the organization works with employees and volunteers to maintain and preserve those lands.<sup>229</sup>

225. See Christopherson & Coffey, *supra* note 8, at 41–42.

226. *Results from Tax Exempt Organization Search*, INTERNAL REVENUE SERV., <https://apps.irs.gov/app/eos/allSearch.do?ein1=&names=Southern+Appalachian+Highlands+Conservancy&resultsPerPage=25&indexOfFirstRow=0&dispatchMethod=searchAll&city=Asheville&state=NC&country=US&postDateFrom=&postDateTo=&exemptTypeCode=all&deductibility=all&sortColumn=orgName&isDescending=false&submitName=Search> [<http://perma.cc/PYS4-4PGJ>] (listing Southern Appalachian Highlands Conservancy as a tax exempt organization).

227. *What We Do*, S. APPALACHIAN HIGHLANDS CONSERVANCY, <https://appalachian.org/what-we-do/> [<https://perma.cc/779V-79H7>].

228. *Id.*

229. Memorandum from Carl Silverstein, Exec. Dir., SAHC, to Buncombe Cty. in Support of SAHC's Application for Prop. Tax Exemption (May 9, 2017) [hereinafter SAHC Exemption Memo] (on file with the North Carolina Law Review).

When SAHC applied for a property tax exemption under the charitable prong of General Statutes section 105-278.7 for its Asheville, North Carolina headquarters, the county tax office rejected it on two grounds.<sup>230</sup> First, the county questioned whether the SAHC's land conservation activities were "charitable" under North Carolina property tax law. Specifically, the county questioned how SAHC's land conservation efforts benefitted "a significant rather than a limited segment of the community," as required by subsection (f)(4) of section 105-278.7 for charitable activities if the general public was not permitted to use much of the land that SAHC has protected through easements and purchases.<sup>231</sup> Second, the county argued that SAHC's commercial activities—charging fees for some guided hikes and for farm-planning workshops—were inconsistent with its allegedly charitable purpose and, as such, should disqualify SAHC from a charitable property tax exemption.<sup>232</sup>

The county's first objection was based on an extremely limited interpretation of what it means to be "charitable" under North Carolina property tax law. The county informed SAHC that the charitable exemption under section 105-278.7 should be reserved for "social-service organizations like food banks, rescue missions, homeless shelters, or Good Will Industries" rather than for conservation organizations such as SAHC.<sup>233</sup>

It is true that North Carolina courts have not ruled on the specific issue of whether a land conservation organization qualifies as a charitable organization for property tax purposes. But, as previously stated, more than thirty years ago the North Carolina Court of Appeals observed that, contrary to Buncombe County's view, "[t]he concept of charity is not confined to the relief of the needy and

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230. Email from Carl Silverstein, Exec. Dir., SAHC, to Christopher McLaughlin, Professor, Univ. of N.C. Sch. of Gov't (Sept. 18, 2017 11:48 AM) [hereinafter Silverstein Email] (on file with the North Carolina Law Review). Note that the dispute between SAHC and the county focused on a building, a former restaurant located just outside of downtown Asheville, that SAHC had recently renovated and was using as its administrative offices. See SAHC Exemption Memo. The dispute did not involve the land held by SAHC and other owners for conservation purposes. Presumably, most of that property would be exempt or partially exempt under the provisions specifically aimed at conservation land. See N.C. GEN. STAT. §§ 105-275(12), -277.15 (2017).

231. Silverstein Email, *supra* note 230; see also N.C. GEN. STAT. § 105-278.7(f)(4) (2017).

232. Silverstein Email, *supra* note 230.

233. *Id.*

destitute.”<sup>234</sup> Numerous other states have addressed this issue and found that land conservancy nonprofits qualify as charitable organizations for purposes of property tax exemptions.<sup>235</sup> As those courts have concluded, the benefits of land conservation efforts accrue to the community as a whole and not, as Buncombe County suggested, only to the landowners who retain the right to hike or otherwise physically enter the land.<sup>236</sup> It seems likely North Carolina courts would apply the same reasoning as have most other state courts and conclude that SAHC and similar organizations would qualify for charitable property tax exemptions.

The county’s second concern about SAHC’s exemption application, focusing on the fees that SAHC charges for some of its activities, was, in the authors’ view, similarly misguided. Most of SAHC’s hikes and related activities are free, but SAHC does charge between ten and twenty dollars for a few of its guided hikes, and between twenty and fifty dollars for its farm-management workshops.<sup>237</sup> In the county’s view, this commercial activity was sufficient to disqualify SAHC from a charitable property tax exemption.<sup>238</sup>

234. *In re Taxable Status of Prop. at 1700 W. Ehringhaus St., Elizabeth City*, 45 N.C. App. 632, 638, 263 S.E.2d 838, 842 (1980) (quoting *Cent. Bd. on Care of Jewish Aged, Inc. v. Henson*, 171 S.E.2d 747, 750 (Ga. Ct. App. 1969)).

235. *See, e.g., New England Forestry Found., Inc. v Bd. of Assessors*, 9 N.E.3d 310, 319–20, 323 (Mass. 2014) (“[W]e have long recognized that ‘charity’ may constitute more than ‘mere alms giving.’ . . . [A]s the science of conservation has advanced, it has become more apparent that properly preserved and managed conservation land can provide a tangible benefit to a community even if few people enter the land. . . . Therefore, because [the nonprofit property owner’s] stated mission and land conservation activities are of the sort to inure to an indefinite number of people and lessen the burdens of government, [it] pursues traditionally charitable purposes and activities within the meaning of [the state property tax exemption statute.]” (citations omitted)); *see also Francis Small Heritage Tr., Inc. v. Town of Limington*, 2014 ME 102, ¶ 18, 98 A.3d 1012, 1019 (citing cases from six other jurisdictions supporting the conclusion that land conservation organizations qualify as charitable organizations for the purposes of property tax exemptions).

236. *Francis Small Heritage Tr.*, 98 A.3d at 1019. Sections 105-278.6 and -278.7 of the General Statutes of North Carolina define a “charitable purpose” in part as one that “benefits humanity or a significant rather than limited segment of the community.” N.C. GEN. STAT. §§ 105-278.6(b), -278.7(f)(4) (2017). As the SAHC website details, that organization’s land conservation efforts protect water quality in streams and rivers, preserve habitat for wildlife and rare plants, and maintain scenic viewsheds of the Southern Appalachians. While not all of the land it conserves is available for public use, most of it is open for hiking and other recreational activities. *What We Do*, *supra* note 227.

237. Upcoming SAHC events and associated charges, if any, are listed on the “Hikes and Events” page of SAHC’s website. *Upcoming Hikes and Events*, S. APPALACHIAN HIGHLANDS CONSERVANCY, <https://appalachian.org/hikes-and-events/> [<http://perma.cc/YT4D-CEUH>].

238. Silverstein Email, *supra* note 230.

SAHC's commercial activity represented a small fraction of its overall revenue—less than one-half of one percent to be exact.<sup>239</sup> But even if the fees from hikes and workshops did represent a substantial portion of SAHC's annual revenue, the authors believe that the strong connection between that commercial activity and SAHC's charitable purpose should have been enough to preserve SAHC's charitable exemption. Unlike Grandfather Mountain's fudge shop and restaurants—which exist solely for revenue-production purposes—SAHC's guided hikes and farm-management workshops relate directly to the organization's charitable goals of promoting and protecting the community's open spaces. Commercial activity that is unrelated to an organization's exempt purpose *should* be a concern when a county reviews a property tax exemption application. Commercial activity that is intimately connected with an organization's exempt purpose—such as SAHC's hikes and workshops and EmPOWERment's business incubation services—should not.<sup>240</sup>

239. According to SAHC's 2016 audited financial statements, revenue from SAHC's event fees represented less than one-half of one percent of its total revenue. Fee revenue was \$27,848 out of \$6,355,151 in total revenue, the rest of which came from donations of cash, land, and services. See CORLISS & SOLOMON PLLC, S. APPALACHIAN HIGHLANDS CONSERVANCY, INC.: INDEPENDENT AUDITOR'S REPORT & FINANCIAL STATEMENTS, YEAR ENDED JUNE 30, 2016, at 4 (Feb. 8, 2017), [https://pp-990-audits.s3.amazonaws.com/24046220161.pdf?X-Amz-Algorithm=AWS4-HMAC-SHA256&X-Amz-Credential=AKIAI7C6X5GT42DHYZIA%2F20180507%2Fus-east-1%2Fs3%2Faws4\\_request&X-Amz-Date=20180507T182053Z&X-Amz-Expires=1800&X-Amz-SignedHeaders=host&X-Amz-Signature=c54c68435ec0b43b84d3832dc0974ee216d926e42d6360d31e86cf2ffe938966](https://pp-990-audits.s3.amazonaws.com/24046220161.pdf?X-Amz-Algorithm=AWS4-HMAC-SHA256&X-Amz-Credential=AKIAI7C6X5GT42DHYZIA%2F20180507%2Fus-east-1%2Fs3%2Faws4_request&X-Amz-Date=20180507T182053Z&X-Amz-Expires=1800&X-Amz-SignedHeaders=host&X-Amz-Signature=c54c68435ec0b43b84d3832dc0974ee216d926e42d6360d31e86cf2ffe938966) [http://perma.cc/7LGC-456D (staff-uploaded archive)].

240. The authors' emphasis on the importance of a relationship between a nonprofit's commercial activity and its charitable goals is supported by a recent Michigan Supreme Court decision. See *Baruch SLS, Inc. v. Tittabawassee Twp.*, 901 N.W.2d 843, 850–52 (Mich. 2017). In *Baruch SLS*, the Michigan Supreme Court concluded that a nonprofit assisted living center may qualify for a property tax exemption despite providing charitable subsidies to only a portion of its clients and charging market-rate fees to most clients. *Id.* at 852. The case stands for two basic propositions, both of which should be equally relevant under North Carolina property tax law as under Michigan property tax law. First, the mere fact that a nonprofit engages in commercial activity, even some commercial activity at market rates, does not automatically disqualify that nonprofit from a property tax exemption. *Id.* Second, a nonprofit's commercial activity with a “reasonable relationship” to the organization's exempt purpose should not threaten its property tax exemption. *Id.* at 850. In the eyes of the Michigan Supreme Court, the only restrictions or conditions on charity that should disqualify an organization from a property tax exemption are those that “bear no reasonable relationship to an organization's legitimate charitable goals.” *Id.* The court went on to list examples of organizations that limit their charitable activities based on criteria that are reasonably related to their charitable goals, contrasting with organizations that do not limit their activities:

Happily for SAHC, it did not need to pursue a formal appeal or litigation to obtain its exemption. After much discussion, the Buncombe County tax office eventually agreed with the nonprofit's arguments and granted it a charitable property tax exemption under General Statutes section 105-278.7 to begin in the 2018–2019 tax year.<sup>241</sup>

This is the correct result, in the authors' view, but the county's initial denial of SAHC's exemption request proves that the issue of nonprofits and their commercial activities remains contentious at the local level. Too often local tax officials adopt a very limited view of what it means to be charitable and reflexively deny property tax exemptions when they involve non-traditional nonprofits providing services other than subsidized food and housing for low-income individuals.

#### IV. A STEP TOWARD CLARITY: THE NEXUS BETWEEN A NONPROFIT'S COMMERCIAL ACTIVITY AND ITS EXEMPT PURPOSE SHOULD BE KEY TO RESOLVING PROPERTY TAX EXEMPTION DISPUTES

How should local governments resolve the property tax conundrum of nonprofits that engage in commercial activity? We have no quibble with the generally accepted approach to North Carolina property tax exemptions, enunciated in *Elon College*. Namely, that the use of the property should control property tax exemptions rather than the use of the profits from the property.<sup>242</sup> In the authors' view, the fact that Elon College and Grandfather Mountain directed profits from their commercial activities back into

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[a] low-cost daycare organized to provide services to low-income families could reasonably prioritize the applications of single-parent families. Single parent households might often, for wholly obvious and understandable reasons, have lower income than households with two parents. . . . This restriction would thus bear a reasonable relationship to the organization's charitable goals. . . . By contrast a low-cost daycare that prioritizes the applications of families who cheer for a certain baseball team should fail this test if the daycare could not show how the restrictions bear a reasonable relationship to a permissible charitable goal.

*Id.* at 851–52.

241. That exemption will first apply in the 2018–2019 tax year, not the 2017–2018 tax year. SAHC could not qualify for an exemption in the 2017–2018 tax year because it was not using the building in question as its headquarters as of January 1, 2017, the date on which eligibility for 2017–2018 tax exemptions was determined. N.C. GEN. STAT. § 105-285(d) (2017) (ownership of real property for taxation purposes is determined annually as of January 1).

242. *Rockingham Cty. v. Bd. of Trs. of Elon Coll.*, 219 N.C. 342, 346–47, 13 S.E.2d 618, 621 (1941).

their exempt activities should not justify an exemption if, as in these cases, the commercial activities were entirely unrelated to the nonprofit's exempt purposes.<sup>243</sup>

However, we believe that when a nonprofit organization's commercial activities are intimately connected with its exempt purpose, then, in the words of *Elon College*, the organization has not "thrust [itself] into the business life of the community,"<sup>244</sup> and a property tax exemption should be justified. If, as in *University for the Study of Human Goodness* case, an educational institution incorporates commercial activity, such as running a restaurant or other business, into its curriculum, the property used for this commercial activity should still be eligible for an educational property tax exemption.<sup>245</sup> If, as in the *Habitat for Humanity*<sup>246</sup> and *EmPOWERment*<sup>247</sup> cases, a community-building nonprofit relies on commercial activity as a key component of its charitable mission while also producing revenue, the property on which that commercial activity occurs should still qualify for a charitable property tax exemption. If, as in the *Southern Appalachian Highlands Conservancy* example,<sup>248</sup> a land conservation generates revenue from guided hikes and responsible farming classes, the nonprofit's headquarters building should still be eligible for a charitable property tax exemption.

Perhaps the best example of how the authors believe entrepreneurial nonprofits should be treated by the property tax system is Triangle Residential Options for Substance Abusers, Inc. ("TROSA"), a substance abuse treatment program very well known in the Raleigh-Durham-Chapel Hill Research Triangle region.

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243. We note that cross-subsidization schemes undertaken by nonprofit organizations raise richly complicated questions under federal laws governing corporate income tax exemptions. No fewer than four federal doctrines—the Operational Test, the Commerciality Doctrine, the Unrelated Business Income Tax, and the Commensurate-in-Scope Doctrine—interact in confusing, unpredictable ways to determine whether such schemes are, or are not, consistent with federal tax-exempt status. *See generally* Kelley, *supra* note 10, at 2472–87 (describing the federal doctrines and arguing that the federal doctrines are vague and inconsistently applied). While North Carolina courts may wish from time to time to seek guidance from federal income tax exemption law on the question of whether a nonprofit organization's commercial activity is or is not closely linked to its exempt purpose, in general we advise North Carolina courts to avoid the federal thicket and develop its own standards.

244. *Elon Coll.*, 219 N.C. at 346, 13 S.E.2d at 621.

245. *See supra* Part III.C for discussion of this case.

246. *See supra* Part III.B for discussion of this case.

247. *See supra* Part III.D for discussion of this case.

248. *See supra* Part III.E for discussion of this case.

A. *The TROSA Model*

TROSA is an extremely effective nonprofit organization located in Durham that is also decidedly commercial. TROSA, which has become a nationally renowned model since its founding in 1994,<sup>249</sup> offers long-term residential substance abuse treatment to several hundred “residents” at any given time.<sup>250</sup> Many of the residents arrive at TROSA as an alternative to incarceration, most qualify as low-income, and none pay for any of the comprehensive treatment they receive.<sup>251</sup>

One essential aspect of TROSA’s treatment regimen is teaching soft skills to its residents that will help them cope with personal and professional challenges once they graduate from the program. Such skills include looking people in the eyes when speaking to them, shaking hands firmly, treating others with courtesy and respect, and showing up to work on time and properly dressed and groomed.<sup>252</sup> Another part of TROSA’s treatment regimen is teaching job skills so that graduates can find work and build futures as productive members of the community.<sup>253</sup>

TROSA teaches these skills by placing residents in various commercial enterprises that it runs. These include a thrift store, a frame shop, a moving company, and a lawncare service, all staffed by recovering addicts.<sup>254</sup> TROSA introduces residents into these commercial activities slowly, but, as they gain skill and confidence, they move into more substantive, sometimes supervisory, roles.<sup>255</sup> The experience they gain in the workplace is consistently incorporated into the therapeutic aspects of the program.<sup>256</sup>

Important for purposes of this discussion, the revenues generated by TROSA’s various businesses go back to TROSA, instead of to the

249. *About Us*, TROSA, <http://www.trosainc.org/about-us> [<https://perma.cc/KG9F-SPCJ>].

250. *Program Services*, TROSA, <http://www.trosainc.org/program-services> [<https://perma.cc/H3SC-4RCG>] (noting that TROSA treats more than 500 residents at a time).

251. *See* TROSA, ANNUAL REPORT (2017), [http://www.trosainc.org/stuff/contentmgr/files/0/0e4f6160033253a6ce6e27be1a4e5921/misc/trosa\\_2016\\_2017\\_annual\\_report\\_print.pdf](http://www.trosainc.org/stuff/contentmgr/files/0/0e4f6160033253a6ce6e27be1a4e5921/misc/trosa_2016_2017_annual_report_print.pdf) [<http://perma.cc/LD7Q-P2PJ>]; *see also* Claire Campbell, *Y’all Got Your Daddy Back*, YAHOO! NEWS (May 29, 2013), <https://www.yahoo.com/news/-y-all-got-your-daddy-back--145356461.html> [<http://perma.cc/LT3E-GQ8V>].

252. *See* Campbell, *supra* note 251.

253. *Id.*

254. *Social Enterprises*, TROSA, <http://www.trosainc.org/social-enterprises> [<https://perma.cc/5QG2-ZZ2W>].

255. *See* Campbell, *supra* note 251.

256. *See id.*

residents themselves.<sup>257</sup> As of its 2016–2017 fiscal year, TROSA’s total public support and revenue was nearly \$21 million, with roughly \$10.8 million of revenue coming from its commercial enterprises.<sup>258</sup>

Despite its entrepreneurial, almost aggressively commercial, approach to drug rehabilitation, TROSA does not and should not pay property taxes on its extensive real estate holdings.<sup>259</sup> Although its businesses generate millions of dollars in net revenue annually, there is an airtight nexus between the business activities and its substance abuse rehabilitation mission. TROSA can argue convincingly that its primary motivation for engaging in the activity for which it is charging money is not the generation of profits, but, rather, the pursuit of its exempt purpose. TROSA property is appropriately exempt from local property taxes.

#### CONCLUSION

Like TROSA, all nonprofits engaged in a blend of intimately related charitable and commercial work should benefit from property tax exemptions. In singling out and lauding the example of TROSA in Durham, we have not lost sight of the fiscal challenges faced by municipal governments across North Carolina. We believe that it is a sensible middle ground, one consistent with nonprofit laws and traditions, to tax real estate that is being used by nonprofit organizations for commercial enterprises that are unrelated to their exempt purposes where the only goal is to generate revenue for the organization’s mission.

But not all nonprofit commercial activity is equivalent. When faced with the conundrum of a nonprofit engaged in commercial activity, local tax officials need to dig in, ask questions, and determine if that activity exists solely for revenue generation (as in the Elon College and Grandfather Mountain examples) or whether that

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257. Although residents do not receive wages for their labor, TROSA provides everything they need during their two-year stay: clothing, shelter, food, transportation, medicine, medical services, etc. Memorandum from Thomas Kelley, Professor, Univ. of N.C. Sch. of Law, to the N.C. Law Review (May 21, 2018) (on file with the North Carolina Law Review). Once they reach a certain level of seniority, they receive “walking around money” to cover the purchase of sundries. *Id.* After graduating from the residential program and securing full-time jobs, many residents pay subsidized rent to TROSA and live with fellow graduates in transitional housing that is scattered through Durham’s residential neighborhoods.

258. See LANGDON & CO., TRIANGLE RESIDENTIAL OPTIONS FOR SUBSTANCE ABUSERS, INC. AND AFFILIATES CONSOLIDATED FINANCIAL STATEMENTS 4 (Oct. 10, 2017), [http://www.trosainc.org/stuff/contentmgr/files/0/b722df1f0c99058869eca38f412f6080/misc/trosa\\_audit\\_6.30.17.pdf](http://www.trosainc.org/stuff/contentmgr/files/0/b722df1f0c99058869eca38f412f6080/misc/trosa_audit_6.30.17.pdf) [<http://perma.cc/D8G8-QQHA> (staff-uploaded archive)].

259. See *id.* (reporting \$15,666,764 in net property and equipment in fiscal year 2017).

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activity is motivated less by revenue concerns and more for programmatic concerns (as in the Human Goodness, EmPOWERment, and SAHC examples). If programmatic concerns outweigh revenue concerns, then the nonprofit should still be eligible for a religious, educational, or charitable exemption. This should be true even if the nonprofit's commercial activity competes directly with for-profit businesses, as is the case with TROSA.

This balanced approach satisfies both legal and policy interests. It upholds the letter and the spirit of North Carolina property tax exemptions laws. It protects local government tax bases by not exempting commercial activities with no beneficial purpose other than revenue generation. And it encourages and protects evolving efforts by nonprofits to creatively benefit the community writ large.

